Supreme Court, U.S.
FILED
OCT - 1 1993

93 - 520
No. 93-

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,
v.
SOUTH CAROLINA DEPARTMENT
OF REVENUE AND TAXATION,
Respondent.

Petition for a Writ of Certiorari to the Supreme Court of South Carolina

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the "substantial nexus" requirement of the Commerce Clause or the "minimum contacts" requirement of the Due Process Clause precludes a state from imposing an income tax upon a corporation with no physical presence in the state but whose trademarks are used in the state by a licensee.

LIST OF PARTIES

The parties are as stated in the caption. In the courts below, the respondent was referred to as the South Carolina Tax Commission. However, effective July 1, 1993, the South Carolina Tax Commission was transferred to and incorporated in the South Carolina Department of Revenue and Taxation pursuant to 1993 S.C. Acts 181, § 1-30-95.

RULE 29.1 STATEMENT

Petitioner Geoffrey, Inc. is a wholly-owned subsidiary of TRU, Inc., which is a wholly-owned subsidiary of Toys "R" Us-N.J., Inc., which is a wholly-owned subsidiary of Toys "R" Us, Inc. Petitioner has no subsidiaries.

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PETITION FOR A WRIT OF CERTIORARI

Geoffrey, Inc. respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of South Carolina in this case.

OPINIONS BELOW

The opinion of the Supreme Court of South Carolina (App. A at 1a-11a) has not yet been reported. The opinion of the Court of Common Pleas of Greenville County, South Carolina (App. B at 12a-27a) is unreported. The Finding of the South Carolina Tax Commission (App. C at 28a-31a) is unreported.

JURISDICTION

The judgment of the Supreme Court of South Carolina was entered on July 6, 1993. The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const., art. I, § 8, cl. 3, provides: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause of the Fourteenth Amendment of the United States Constitution, U.S. Const., amend. XIV, § 1, provides: "No State shall . . . deprive any person of life, liberty, or property, without due process of law."

Relevant portions of the South Carolina statutes are set forth at App. E at 34a-36a.

STATEMENT

This case raises a question of extraordinary importance to state taxpayers and state taxing authorities throughout the nation: whether a state may levy a tax upon a corporation with no physical presence in the state. Less than two years ago, the Court gave a negative answer to that question in adjudicating the constitutionality of a state's attempt to impose a use tax collection obligation upon a mail-order seller with no physical presence in the state. *Quill Corp. v. North Dakota,* 112 S. Ct. 1904 (1992). The Court in *Quill,* however, specifically left open the question whether the "bright-line, physical-presence requirement" (*id.* at 1916) applicable to sales and use taxes would apply as well to other types of state taxes. *Id.* at 1914-16. That issue is squarely presented by this case.

1. The Facts

Petitioner Geoffrey, Inc. ("Geoffrey") is a Delaware corporation with its principal place of business in Wilmington, Delaware. During the years in question, Geoffrey was a second-tier subsidiary of Toys "R" Us, Inc.

("Toys 'R' Us"), the world's largest retailer of children's toys.[1]

a. ***The creation of Geoffrey***

In 1984, in conjunction with a corporate restructuring at Toys "R" Us, Geoffrey was organized for the purpose of holding and managing the trademarks of Toys "R" Us. R. 42-43.[2] These trademarks included the "Toys 'R' Us" trademark as well as related marks ending with " 'R' Us" ("Kids 'R' Us," "Books 'R' Us," "Sports 'R' Us," etc.).[3] By placing its trademarks in a separate subsidiary, Toys "R" Us could control the principal functions associated with the trademarks, such as licensing and defending them,[4] through a discrete and specialized legal entity. Segregation of the trademarks also enabled Toys "R" Us to measure more accurately the contribution that the trademarks were making to its overall organization (R. 43) and to ensure "that they would not get comingled [*sic*] with what was going on with the rest of the organization." R. 43.

b. ***The location of Geoffrey***

The corporate restructuring that, among other things, transferred the "Toys 'R' Us" trademarks to Geoffrey also

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[1] During the tax years at issue (1986 and 1987), Geoffrey was a wholly-owned subsidiary of TRU, Inc., which, in turn, was a wholly-owned subsidiary of Toys "R" Us. Since 1991, Geoffrey has been a third-tier subsidiary of Toys "R" Us. *See* Rule 29.1 Statement.

[2] Citations to the Record on Appeal in the Supreme Court of South Carolina are designated "R." followed by a page reference.

[3] The distinctive character of the mark is accentuated by the fact that, as actually displayed, the "R" is backwards.

[4] Over the years, Geoffrey has brought numerous lawsuits in the federal courts to protect its trademarks from infringement. In June 1990, at the time of the hearing before the South Carolina Tax Commission, fourteen such actions were pending. R. 41, 160-61.

offered Toys "R" Us the opportunity to realize state tax savings in limited circumstances. By holding the trademarks in Geoffrey, and having Geoffrey license the trademarks for a royalty to Toys "R" Us, its affiliates, and unrelated parties, Toys "R" Us could reduce its state tax liability without any offsetting increase in Geoffrey's tax liability if (1) Geoffrey were located in a state that did not tax its income, and (2) Toys "R" Us operated in a state that measured its tax liability without combining its income with that of its affiliates, such as Geoffrey. Under these conditions, Toys "R" Us' taxable income would be decreased due to the deductible royalty payments made to Geoffrey. The corresponding increase in Geoffrey's royalty income, however, would not be taxed by the state where Geoffrey was located.

In light of these potential state tax savings, when Toys "R" Us created Geoffrey in January 1984, it chose to establish it in Delaware. Delaware has long sought to attract corporations to the state by, among other things, exempting from income tax corporations whose activities within the state "are confined to the maintenance and management of their intangible investments" such as trademarks. Del. Code Ann. tit. 30, § 1902(b)(8) (1985 & Supp. 1992). Toys "R" Us responded to that incentive by locating its trademark licensing company in Delaware. R. 43-44.

c. The trademark license agreement

In August 1984, following the transfer of "Toys 'R' Us" and related trademarks to Geoffrey, Geoffrey entered into a license agreement with Toys "R" Us granting Toys "R" Us a nonexclusive license to use the trademarks in its United States business (except for five states). R. 116-33. Under the license agreement, Toys "R" Us agreed to pay Geoffrey one percent of the net sales of products sold

or services rendered under the licensed mark. R. 119. Geoffrey also entered into similar license agreements with other related and unrelated corporations. R. 36, 213. Toys "R" Us reports its sales revenues to Geoffrey on an aggregate basis without attributing the revenues to any particular state. R. 37-38, 120.

d. *Geoffrey's contacts with South Carolina*

When Geoffrey and Toys "R" Us entered into their trademark license agreement, Toys "R" Us was not doing business in South Carolina. It was not until October 1985, more than a year after the license agreement was executed, that Toys "R" Us opened its first store in South Carolina. R. 33. During the tax years at issue (1986 and 1987),[5] Toys "R" Us earned income from its South Carolina operations on which it paid South Carolina income taxes of $25,843 and $68,438. R. 162, 187. During this period, Toys "R" Us paid royalties to Geoffrey on Toys "R" Us' sales, including those from South Carolina.[6] At no time did Geoffrey have any employees, offices, or real or tangible personal property in South Carolina.

2. The Assessment

The South Carolina Tax Commission (the "Commission")[7] conducted an income tax audit of Toys "R" Us for tax years 1986 and 1987. As a result of the audit, the

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[5] Both Geoffrey and Toys "R" Us reported on a fiscal year basis ending February 2, 1986, and February 1, 1987.

[6] As noted above, Toys "R" Us did not report its royalties to Geoffrey on a geographically identifiable basis. The South Carolina Tax Commission apparently determined the amount of Geoffrey's royalties attributable to South Carolina by taking one percent of the South Carolina sales that Toys "R" Us reported in apportioning its income to the state. R. 103.

[7] Effective July 1, 1993, the South Carolina Tax Commission was transferred to and incorporated in the South Carolina Department of Revenue and Taxation pursuant to 1993 S.C. Acts 181, § 1-30-95.

Commission proposed income tax deficiencies against Toys "R" Us. R. 215-22. Insofar as here relevant, the proposed assessment was initially based on the Commission's position that Toys "R" Us was not entitled to deduct the royalties it had paid to Geoffrey because Geoffrey was "a paper corporation" (R. 219) and the royalty expenses paid to Geoffrey entailed "an arbitrary shift" (R. 219) of income and expenses. After Toys "R" Us protested the assessment on the grounds, among others, that there was no basis for disregarding Geoffrey as a separate corporate entity or for questioning the fairness of the royalty payments made by Toys "R" Us to Geoffrey,[8] the Commission advanced an alternative argument, which is the focus of this petition: namely, that Geoffrey itself, wholly apart from its status as a subsidiary of Toys "R" Us, was subject to tax in South Carolina on the royalties it received as a result of Toys "R" Us' South Carolina operations.

Following a hearing, the Commission reversed its initial position attacking Geoffrey's status as a separate corporate entity and the arm's-length basis for the license agreement. It concluded instead that "the royalty payments to Geoffrey by Toys are deductible by Toys as part of the computation to arrive at Toy's [*sic*] apportionable income." App. C at 29a. At the same time, however, the Commis-

[8] Unlike many states, *see* 1 Multistate Corporate Income Tax Guide (CCH) ¶ 185 (1993), South Carolina does not require combined reporting of unitary affiliates for state income tax purposes. Rather, it strictly respects the separate status of related corporate entities. S.C. Code Regs. 117-77 (1992). The South Carolina Supreme Court's comment that Geoffrey "paid no income taxes to any state" (App. A at 3a n.1) is thus misleading and irrelevant. In fact, Geoffrey's income was effectively included in the apportionable tax base of every state in which Toys "R" Us filed combined reports. In any event, the fact that Delaware, for legitimate reasons of state policy, has chosen not to tax the income of companies like Geoffrey does not enlarge South Carolina's power to tax such income.

sion found that Geoffrey had a sufficient nexus with South Carolina to subject it to tax on the royalties derived from Toys "R" Us' South Carolina sales. *Id.* On this basis, it issued a notice of assessment against Geoffrey for $10,612 taxes plus interest. R. 258.[9]

3. The Decisions Below

After paying the contested taxes under protest, Geoffrey brought suit for a refund challenging the assessment on the ground, among others, that Geoffrey lacked a sufficient nexus with South Carolina to satisfy the requirements of the Commerce and Due Process Clauses. R. 26-27. Ruling without the benefit of this Court's opinion in *Quill*, the trial court rejected Geoffrey's constitutional claims. The court proceeded from the premise—subsequently repudiated in *Quill* (112 S. Ct. at 1913)—that "[t]he United States Supreme Court has found that the requirement for satisfying a 'minimal connection' for nexus is the same for both Due Process and Interstate Commerce." App. B at 19a. On this assumption, the court viewed its task as "simply one of asking whether the state has provided some protection, opportunity, or benefit for which it can ask a return." *Id.*

The court found South Carolina had met this standard with respect to Geoffrey on two theories. First, the court viewed Geoffrey's "exploitation of [the] state's market" (App. B at 20a) as "a sufficient basis upon which to find a valid nexus" (*id.*) under the Due Process and Commerce Clauses regardless of the taxpayer's physical presence in the state. Second, the court found that Geoffrey's

[9] At the same time, the Commission assessed Geoffrey with a minimum corporate license fee, which is based on capital employed in South Carolina, of $15 per year for the periods ending January 31, 1987, and January 31, 1988. R. 259. Geoffrey's constitutional objections to the South Carolina income tax are equally applicable to the license fee, and its petition for review of the judgment below is directed to both taxes. Because of the relative insignificance of the license fee, however, no further reference will be made to it in this petition.

intangible property—in the form of a franchise and the receivables arising out of the license agreement—was "located in South Carolina" (*id.* at 21a), thus providing a second predicate for South Carolina's constitutional nexus with Geoffrey.

The Supreme Court of South Carolina affirmed. Devoting most of its analysis to Geoffrey's due process claim, the court observed that "[t]he nexus requirement of the Due Process Clause can be satisfied even where the corporation has no physical presence in the taxing state if the corporation has purposefully directed its activity at the state's economic forum." App. A at 4a (citing *Quill*). Although Toys "R" Us had no South Carolina stores when it entered into the trademark license agreement with Geoffrey, the court determined that Geoffrey had nevertheless purposefully directed its activities towards South Carolina "[b]y electing to license its trademarks and trade names for use by Toys R Us in many states" without prohibiting their use in South Carolina. *Id.* at 5a.

Like the trial court, the South Carolina Supreme Court relied on "the presence of Geoffrey's intangible property in this State" (App. A at 5a) as an alternative ground for its due process determination. The court found that the situs of Geoffrey's franchise and accounts receivable was in South Carolina and that the "presence" of these intangibles provided the "'minimum connection'" between Geoffrey and the state required by the Due Process Clause. *Id.*

The South Carolina Supreme Court disposed of Geoffrey's Commerce Clause claim in two brief paragraphs. App. A at 9a-10a. It put *Quill* to one side on the premise that *Quill*'s reaffirmation of the physical-presence requirement applied solely to sales and use taxes. *Id.* at 9 n.4. The court therefore did not consider whether the concerns that animated the Court's adoption of the bright-line, physical-presence requirement in *Quill*—the burden that a more flexible rule would impose on interstate com-

merce and respect for *stare decisis*—were equally applicable to the case at hand. Instead, the South Carolina court relied on the same considerations that underlay its due process analysis—the existence of state-provided protections and benefits—in concluding that Geoffrey had a "substantial nexus" with South Carolina under the Commerce Clause. *Id.* at 10a.

REASONS FOR GRANTING THE PETITION

The South Carolina Supreme Court has issued a decision with staggering implications for taxpayers doing business across state lines, particularly the ever-increasing number of taxpayers who deal with intangible property. In substance, the court has held that, regardless of a taxpayer's tangible contacts with a state, the taxpayer is subject to the state's constitutional taxing jurisdiction so long as the taxpayer derives some economic benefit from the state's market. Under the court's holding, an author paid royalties by a publisher from the sale of a book would be subject to tax in every state in which the book was sold. A television producer paid royalties by a network for the use of a program would be subject to tax in every state in which the program was televised. An electronic data bank receiving payments for the use of its services would be subject to tax in every state in which its logo flashed across the computer screen.

There are three compelling reasons for the Court to grant review of the decision below. First, the decision raises an issue of utmost importance to the Court's Commerce Clause jurisprudence: whether a state may impose an income tax on a taxpayer with no physical presence in the state. The Court left this fundamental constitutional question open in *Quill*, and it should settle it now. Second, wholly apart from any Commerce Clause restraint on state taxation, the case presents a substantial question under the Court's Due Process Clause jurisprudence: whether a trademark licensor has "purposefully directed" its activity towards any state in which the licensee exploits the

trademark and, if so, whether the assertion of taxing jurisdiction under these circumstances would comport with " 'fair play and substantial justice.' " *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985) (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 320 (1945)). Extreme uncertainty regarding the meaning of the Court's personal jurisdiction cases and their impact in the state tax context warrants additional guidance from this Court. Finally, the basic tax nexus issue presented by this case is one of enormous practical significance that will create chaos in interstate tax administration unless resolved by this Court.

I. THIS COURT SHOULD RESOLVE THE QUESTION WHETHER *QUILL*'S "BRIGHT-LINE, PHYSICAL-PRESENCE" STANDARD APPLIES TO STATE CORPORATE INCOME TAXES

In *Quill*, this Court held that the "substantial nexus" requirement of the Commerce Clause precludes a state from compelling a mail-order vendor with no physical presence in the state to collect use taxes on goods sold to in-state purchasers. In so holding, the Court differentiated the nexus requirements of the Due Process and Commerce Clauses:

> [T]he due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him . . . . In contrast, the Commerce Clause, and its nexus requirement, are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.

Quill, 112 S. Ct. at 1913. Based on these Commerce Clause concerns, and on considerations of *stare decisis*, the Court reaffirmed the "bright-line, physical-presence requirement" (*id.* at 1916) of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), for state jurisdiction to impose sales and use taxes.

While reaffirming the physical-presence nexus requirement for sales and use taxes, the Court observed in *Quill* that it had not explicitly extended that requirement to other types of taxes. Thus the Court noted that "we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* establishes for sales and use taxes" (*Quill,* 112 S. Ct. at 1914) and that "in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement . . . ." *Id.* at 1916. At the same time, however, the Court warned that "silence does not imply repudiation of the *Bellas Hess* rule" (*id.* at 1914) and that the reasoning of its cases outside the sales and use tax area did "not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes." *Id.* at 1916. So, too, the Court's silence in those cases does not compel a rejection of a physical-presence requirement for other types of taxes.

The uncertainty thus created by *Quill* over the application of the bright-line, physical-presence standard outside the area of sales and use taxes is an unresolved constitutional question of major dimension that warrants this Court's plenary consideration. Its resolution plainly should not be left to the perfunctory treatment it received at the hands of the court below. That court dismissed the question in a footnote, misreading this Court's statement that it had not explicitly "articulated" (*Quill,* 112 S. Ct. at 114) a physical-presence requirement outside the sales and use tax context as meaning that such a requirement had been rejected in every other taxing context. App. A at 9a n.4.

As this Court pointed out in *Quill,* however, precisely the opposite was true. All of the cases which the state court in *Quill* had invoked as eroding the physical-presence requirement "involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of *Bellas Hess* . . . ." *Quill,* 112 S. Ct. at 1914. Indeed, the Court has *never* held in *any*

state tax case that the nexus requirement of the Commerce Clause can be satisfied in the absence of a taxpayer's physical presence in the state.[10] It is hardly the prerogative of a state court to determine that this unbroken line of precedent should be abandoned; that there is one nexus standard governing sales and use taxes and another for all other types of taxes;[11] and that a sea change is to be made in this Court's Commerce Clause doctrine. For these reasons alone, it is incumbent upon this Court to review the decision below.

Moreover, the essential question whether the Court's Commerce Clause jurisprudence should be modified outside the sales and use tax context cannot be answered intelligently without considering the factors that led the Court to reaffirm the physical-presence standard in *Quill*. In *Quill*, the Court noted the benefits of a "bright-line" rule which avoids "[u]ndue burdens on interstate commerce . . . by the demarcation of a discrete realm of commercial activity that is free from interstate taxation."

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[10] In purported support of the allegedly "well settled" proposition "that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there" (App. A at 9a), the court below cited two cases: *International Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 441-42 (1944), and *Curry v. McCanless*, 307 U.S. 357, 368 (1939). Each case is irrelevant on two counts. First, neither case involved the Commerce Clause; the cases raised only due process issues. Second, in both cases the state's taxing power was exerted with respect to physically-present entities—the tax-withholding corporation in *International Harvester* and the local trust companies in *Curry*.

[11] Indeed, this dubious distinction has already been rejected by one state court. *Guardian Indus. Corp. v. Department of Treasury*, 198 Mich. App. 363, 377, 499 N.W.2d 349, 356 (1993) (Commerce Clause "substantial nexus" test of physical presence applies to Michigan Single Business Tax); *cf. D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988), where the Court observed that the four-pronged Commerce Clause test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), applied uniformly to a wide variety of state taxes, in response to the taxpayer's argument that the test did not apply to a tax on goods in the stream of commerce. Brief for Appellant at 16-24, *D.H. Holmes*.

Quill, 112 S. Ct. at 1914. Such a rule "firmly establishes the boundaries of legitimate state authority"; it "reduces litigation"; it "encourages settled expectations and, in doing so, fosters investment by businesses and individuals"; and, when long-standing precedent supports the rule, it serves the " 'interest in stability and orderly development of the law' that undergirds the doctrine of *stare decisis* . . . ." *Id.* at 1915-16.

The court below did not even purport to consider these factors. Thus it failed to consider whether the case for a "bright-line" rule of "substantial nexus" is any less compelling in the income tax context than in the sales and use tax context; it failed to consider whether the "settled expectations" (*Quill*, 112 S. Ct. at 1915) of income taxpayers are any less worthy of constitutional respect than the settled expectations of sales and use taxpayers; and it failed to consider whether "principles of *stare decisis*" (*id.* at 1916) are less relevant to income taxes than to sales and use taxes, particularly when Congress has the ultimate power to prescribe the appropriate rules in this area. *Id.* In fact, each one of these factors applies with equal force to state income taxpayers as to state sales and use taxpayers. Consequently, unless this Court grants review to explore these questions, the South Carolina court effectively will have engineered a dramatic change in the Commerce Clause restraints on state taxation by judicial fiat.

Finally, even if the Court were to determine that the bright-line, physical-presence standard of "substantial nexus" had no application outside the sales and use tax area, the Court's guidance is sorely needed nonetheless to give content to the concept of "substantial nexus." To be sure, the Court indicated in *Quill* that "the 'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." *Quill*, 112 S. Ct. at 1913. Accordingly, the Court further observed, "a corporation may have the 'minimum con-

tacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause." *Id.* at 1913-14. But these thoughts were entirely lost on the court below, which simply applied a due process "benefits-and-protections" analysis in finding "substantial nexus" under the Commerce Clause. *See supra* pp. 8-9. In light of the manifest burdens that will be imposed on interstate commerce if the ruling below is allowed to stand unrevised, *see infra* pp. 20-23, it is essential for this Court to review this case and to delineate the meaning of "substantial nexus" in a manner that is more protective of Commerce Clause concerns.

II. THE STATE COURT'S RULING THAT A LICENSEE'S USE OF A TRADEMARK IN A STATE CONFERS JURISDICTION TO TAX AN OUT-OF-STATE LICENSOR RAISES A SUBSTANTIAL DUE PROCESS QUESTION WARRANTING THIS COURT'S REVIEW

As this Court explained in *Quill*, the due process restraints on state power to tax are "[c]omparable" to those on state power to adjudicate. *Quill*, 112 S. Ct. at 1911. Under the Court's contemporary due process jurisprudence, a state's power to adjudicate (and thus, presumptively, to tax) depends on "whether a defendant had minimum contacts with the jurisdiction 'such that the maintenance of the suit does not offend "traditional notions of fair play and substantial justice." ' " *Id.* at 1910 (quoting *International Shoe*, 326 U.S. at 316 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940))). Under this two-pronged analysis, a state may subject a foreign corporation to its adjudicatory or taxing jurisdiction under the Due Process Clause only if (1) "a defendant purposefully established minimum contacts within the forum State," *Burger King*, 471 U.S. at 476, and, if so, (2) "the assertion of personal jurisdiction would comport with 'fair play and substantial justice.' " *Id.* (quoting *International*

Shoe, 326 U.S. at 320). Whether Geoffrey is subject to tax by South Carolina under either of these criteria raises a substantial question of national significance warranting this Court's attention.

A. The Decision Below Raises the Substantial Question Whether a Trademark Licensor "Purposefully" Establishes "Minimum Contacts" with a State by Virtue of the Licensee's Use of the Trademark in That State

The initial due process question raised by this case is whether Geoffrey, by licensing Toys "R" Us to use its trademarks, has "purposefully avail[ed] itself of the benefits of an economic market" (*Quill*, 112 S. Ct. at 1910) in South Carolina because Toys "R" Us uses Geoffrey's trademarks there. Although Toys "R" Us had no stores in South Carolina when Geoffrey and Toys "R" Us entered into their license agreement, and Geoffrey had no role in Toys "R" Us' decision to enter the South Carolina market, the court below nevertheless concluded that Geoffrey had "purposefully directed its activities toward South Carolina's economic forum . . . ." App. A at 5a. The court inferred such "purposeful direction" from the fact that Geoffrey had not prohibited Toys "R" Us from using the trademarks in South Carolina and that Geoffrey "contemplated" and was "aware of" the possibility that its trademarks might be used in South Carolina. *Id.* The conclusion, however, that the mere foreseeability of a trademark licensee's future choice to use the mark in a state suffices to subject that corporation to the state's jurisdiction under the Due Process Clause is highly questionable in light of *Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102 (1987).

In *Asahi*, Justice O'Connor, writing for herself, the Chief Justice, and Justices Powell and Scalia, expressed the view that the Due Process Clause requires "something more than that the defendant was aware of its product's entry into the forum State through the stream of com-

merce in order for the State to exert jurisdiction over the defendant." *Asahi*, 480 U.S. at 111. Rather, "[t]he 'substantial connection' . . . between the defendant and the forum State necessary for a finding of minimum contacts must come about by *an action of the defendant purposefully directed toward the forum State.*" *Id.* at 112 (emphasis in original). Consequently, "a defendant's awareness that the stream of commerce may or will sweep the product into the forum State does not convert the mere act of placing the product into the stream of commerce into an act purposefully directed toward the forum State." *Id.* Justice Stevens likewise recognized the existence of a constitutional line between " 'mere awareness' that a component will find its way into the forum State and 'purposeful availment' of the forum's market." *Id.* at 122 (Stevens, J., concurring in part and concurring in the judgment).[12]

Under the views expressed by Justice O'Connor in *Asahi*—views utterly ignored by the court below—it is apparent that there is a substantial due process question raised by South Carolina's assertion of jurisdiction to tax Geoffrey. There was no "action *of the defendant* purposefully directed toward the forum State." *Asahi*, 480 U.S. at 112 (original emphasis partially omitted). Rather, by licensing Toys "R" Us to use its trademarks, Geoffrey was merely releasing its intangible "product" into the stream of commerce. Whether that "product" would find its way into South Carolina was wholly within the control

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[12] Justice Stevens did not believe, however, that this line was "unwavering" (*Asahi*, 480 U.S. at 122), and felt that the determination whether such conduct "rises to the level of purposeful availment requires a constitutional determination that is affected by the volume, the value, and the hazardous character of the components." *Id.* Justice Brennan, writing for himself and Justices White, Marshall, and Blackmun, was of the view that a defendant who can reasonably anticipate that its products will be distributed in a state has sufficient contacts with a state to be subject to the state's jurisdiction. *Id.* at 117-21.

of Toys "R" Us. The state court's speculation that Geoffrey could have "contemplated" or been "aware of" the possibility that Toys "R" Us might in the future use Geoffrey's trademarks in South Carolina does not establish that Geoffrey "purposefully directed" its activities towards the South Carolina market. *See also World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980) (foreseeability that product sold by out-of-state wholesaler and retailer might be used in state insufficient to establish jurisdiction over wholesaler and retailer under Due Process Clause).

Apart from the state court's questionable reliance on a "foreseeability" standard of jurisdiction, Geoffrey's relationship with South Carolina failed to satisfy the Court's "minimum contacts" standard. Geoffrey had no palpable contacts with South Carolina: all of Geoffrey's dealings were with the Toys "R" Us out-of-state headquarters; Geoffrey had no officers, agents, or tangible property in South Carolina; it did not advertise or otherwise solicit business in South Carolina; it did not create or control a distribution system there; and it did not establish channels for providing regular advice to customers there. Geoffrey's contacts with South Carolina thus fall short of the "minimum contacts" the Court has found sufficient to sustain a state court's jurisdiction in other cases. *See Burger King* (minimum contacts established where out-of-state franchisee entered into contract with franchisor headquartered in forum state, where all relevant payments were sent, agreements were made and enforced, and decision-making authority was exercised); *Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770 (1984) (minimum contacts established where out-of-state defendant continuously and deliberately exploited the forum state's market by monthly distribution of thousands of magazines); *Quill* (minimum contacts found where defendant systematically exploited the forum state by soliciting business through catalogs, flyers, and other media).

Finally, the decision below is rendered no less suspect constitutionally by its suggestion that the "minimum contacts" requirement was "satisfied by the presence of Geoffrey's intangible property in [South Carolina]." App. A at 5a. The theory of *in rem* jurisdiction on which the suggestion is based—that the presence of a nonresident defendant's property in the state automatically provides a predicate for asserting jurisdiction over the nonresident—was repudiated by this Court in *Shaffer v. Heitner*, 433 U.S. 186 (1977). In *Shaffer*, the Court abandoned the distinction between *in rem* and *in personam* jurisdiction for due process purposes and held that all assertions of jurisdiction must be evaluated according to the "minimum contacts" standard of "fair play and substantial justice" established by *International Shoe* and its progeny. *Shaffer*, 433 U.S. at 212. Accordingly, even if the fiction were embraced that Geoffrey's intangible property is "located" in South Carolina for some purposes, that conclusion would not establish jurisdiction to tax under modern due process analysis.

B. The Decision Below Raises the Substantial Question Whether the Establishment of Jurisdiction over an Out-of-State Trademark Licensor Because the Trademark Is Used in the State by the Licensee Offends "Traditional Notions of Fair Play and Substantial Justice"

Wholly apart from the substantial question whether Geoffrey has sufficient "minimum contacts" with South Carolina to satisfy the due process requirements, the case raises an equally substantial question under the second prong of the Court's due process analysis: whether the assertion of jurisdiction "would offend '"traditional notions of fair play and substantial justice."'" *Asahi*, 480 U.S. at 113 (citations omitted). The court below simply ignored this issue.

It is plain that South Carolina's assertion of taxing jurisdiction in this case raises significant fairness concerns

to Geoffrey and to similarly situated taxpayers throughout the United States. *See infra* pp. 20-23. Under the ruling below, any person who licenses another to use a patent, copyright, or similar intangible would find itself subject to tax in any jurisdiction in which the licensee chose to use the intangible. A licensor like Geoffrey would be forced either to monitor closely the business activities of each of its licensees to determine to what extent the licensee's activities in various states were generating portions of its income or to risk widespread exposure to taxation in state and local taxing jurisdictions with which it has no contact. In light of self-reporting requirements and severe penalties for noncompliance, not to mention the inapplicability of any statute of limitations to taxpayers who have not filed returns, the burden that either alternative would impose on Geoffrey and innumerable other taxpayers would be overwhelming.

While the interest of the taxing state must likewise be considered, the state's claim for a "fair share" of tax revenues would appear to be at its weakest when income from intangibles is at issue. A licensor of intangibles with no physical presence in the state imposes virtually no social costs on the state. It has no employees that receive police protection or property that receives fire protection. It does not use the state's roads, navigate its waters, or utilize its landfills.

However the Court might ultimately strike the balance, the question whether the assertion of jurisdiction in this case comports with "traditional notions of fair play and substantial justice" merits this Court's consideration.

III. THE QUESTION PRESENTED HAS ENORMOUS PRACTICAL SIGNIFICANCE AND SHOULD BE RESOLVED BY THIS COURT TO AVERT CHAOS IN INTERSTATE TAX ADMINISTRATION

The practical implications of the South Carolina Supreme Court's sweeping conception of state tax jurisdiction are simply astonishing. Under the court's ruling, whenever a person's intangible property is used by others, the person will be subject to tax wherever such property is used. A small, start-up company in Silicon Valley will be subject to tax in every state in which its software licensees operate, even if, like Geoffrey, it has no office, employees, or tangible property in the state and has never solicited business there. A bank purchasing a security representing a bundle of loans will be subject to tax in every state in which the underlying borrowers reside because, just as "[t]he real source of Geoffrey's income is not a paper agreement, but South Carolina's Toys R Us customers" (App. A at 8a), so the "real source" of the bank's income is not the security but the underlying borrowers spread across the nation. An athlete receiving royalties from his or her endorsement of a product will be subject to tax in every state in which the product is sold, regardless of any other connection the athlete may have had with the state, because the athlete, like Geoffrey, failed to prohibit the use of the endorsement in those states, and thus "consented to, and benefitted from" (App. A at 5a) the licensee's use of intangible property in the state. A company receiving payment for a covenant not to compete will be taxable in every state in which it has agreed *not* to do business because that is where the covenantee is enjoying the intangible rights that are the "source" of the covenantor's income. The list goes on and on. *See supra* p. 9.

Nor is this parade of horribles imaginary. State tax officials across the country have already seized upon the *Geoffrey* case as a vehicle for expanding their jurisdiction

to tax. The Wisconsin Department of Revenue, which in the past had "not aggressively asserted the licensing of intangibles as a nexus-creating event," is "monitoring *Geoffrey* to decide how aggressively to pursue this issue." Robert M. Fahrenbach, *DOR to Monitor* Geoffrey *Case, Intercompany Transactions,* State Tax Notes, July 26, 1993, at 200. The Florida Department of Revenue "published a substantial rewrite of the rules governing the state's corporate income tax . . . to provide an indication of . . . the department's position on issues similar to those raised in South Carolina in the *Geoffrey (Toys "R" Us)* case." William D. Townsend, *Revenue Department Drafts Substantial Rewrite of Corporate Income Tax Rules,* State Tax Notes, July 5, 1993, at 7.[13] And the Federation of Tax Administrators has advised its members that, if Geoffrey failed to seek Supreme Court review, "the case could become a basis for other state courts to hold companies subject to income and franchise taxes on the basis of economic presence. Companies particularly at risk would be those who provide services, such as financial institutions, and brokers." Federation of Tax Administrators, *South Carolina High Court Applies* Quill *Decision,* Tax Administrators News, July 1993, at 69, 80.

Indeed, petitioner has been made acutely aware of the national implications of the South Carolina Supreme

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[13] The proposed changes in Florida's corporate income tax rules (Rule 12C-1.011) provide in part:

> (1) The following activities . . . will be construed as conducting business, earning or receiving income in this state . . . .
>
> (r) selling or licensing the use of intangible property in Florida. For example, licensing the use of a trade name or trademark to a franchise.

Florida Department of Revenue Rewrites Corporate Income Tax Rules, Fla. Admin. Weekly, Vol. 19, No. 24, June 18, 1993, *available in* LEXIS, FLA Library, FLADMN File, 93 STN 125-2.

Court's decision. Shortly after the decision below was rendered, the Multistate Tax Commission's "National Nexus Program" contacted Toys "R" Us indicating its "understand[ing] that . . . Geoffrey, Inc. may be transacting . . . business . . within the jurisdiction of various states" and observing that "[m]any states impose income tax nexus based on minimal activities (including the licensing of intangible property rights) performed within the State." Letter from Alice J. Davis, Director, Multistate Tax Commission, National Nexus Program, to John Salvia, Tax Manager, Toys R Us, August 20, 1993 (reproduced in full in App. D).

The burdens that this expanded state tax jurisdiction will impose on taxpayers, particularly small and medium-sized business, are immense. Corporations deriving income from intangible property exploited by others across state lines will suddenly find themselves saddled with the obligation to comply with the tax laws of dozens of states with which they have no familiarity. They will be required to file estimated and final returns, maintain records, and engage legal and accounting personnel to comply with the states' self-reporting requirements, upon the pain of large penalties should they fail to do so. The risks of noncompliance are exacerbated by the fact that taxpayers who have failed to file returns are not protected by statutes of limitations. The cost of complying with the varying income tax regimes of different states may well exceed the burden of the taxes themselves, especially in the case of small companies. In fact, the taxes involved in this case amount to less than $11,000 for the two years at issue (R. 258)—an amount that already has been dwarfed by the cost of compliance.

Even on the most sanguine of assumptions regarding taxpayers' ability to comply with the South Carolina Supreme Court's brave new world of state taxing jurisdiction, the court's decision, if left undisturbed, will spawn uncertainty and confusion in state tax administration.

Indeed, the Michigan Court of Appeals, in a decision that directly conflicts with the decision of the court below, has held that *Quill's* bright-line, physical-presence standard of Commerce Clause nexus is not limited to sales and use taxes. *Guardian,* 198 Mich. App. at 377, 499 N.W.2d at 356. Only by resolving the key issues raised by the decision below will the Court be able to stem the inevitable tide of litigation and concomitant disarray that will burden state taxpayers and state tax administrators alike.

CONCLUSION

The decision below has created a critical need for further guidance from this Court. Not only does it raise substantial, unresolved questions under the Commerce and Due Process Clauses, it also produces practical problems of enormous significance that demand this Court's attention.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: October 1, 1993

APPENDIX A

THE STATE OF SOUTH CAROLINA
IN THE SUPREME COURT

GEOFFREY, INC.,
Appellant,

v.

SOUTH CAROLINA TAX COMMISSION,
Respondent.

Appeal from Greenville County
Larry R. Patterson, Judge

Opinion No. 23886
Heard April 7, 1993—Filed July 6, 1993

AFFIRMED

Cary H. Hall, Jr., of Wyche, Burgess, Freeman & Parham, P.A., of Greenville, for Appellant.

Chief Deputy Attorney General Ray N. Stevens and Deputy Attorney General Ronald W. Urban, both of Columbia, for Respondent.

HARWELL, C.J.: Geoffrey, Inc. (Geoffrey), a foreign corporation, appeals from a ruling that requires it to pay South Carolina income tax and business license fees. We affirm.

I. FACTS

Geoffrey is a wholly-owned, second-tier subsidiary of Toys R Us, Inc. (Toys R Us) incorporated in Delaware with its principal offices in that state. It has no employees or offices in South Carolina and owns no tangible property here.

In 1984, Geoffrey became the owner of several valuable trademarks and trade names, including "Toys R Us." Later that year, Geoffrey executed a License Agreement (Agreement) that allows Toys R Us to use the "Toys R Us" trade name, as well as other trademarks and trade names, in all states except New York, Texas, Pennsylvania, Massachusetts, and New Jersey. The Agreement further grants Toys R Us a right to use Geoffrey's merchandising skills, techniques, and "know-how" in connection with marketing, promotion, advertising, and sale of products covered by the Agreement.

As consideration for the licenses granted by the Agreement, Geoffrey receives a royalty of one percent "of the net sales by [Toys R Us], or any of its affiliated, associated, or subsidiary companies, of the Licensed Products sold or the Licensed Services rendered under the Licensed Mark." Toys R Us reports the aggregate sales of all stores to Geoffrey in a single figure on a monthly basis. The royalty payment is made annually via wire transfer from a Toys R Us account in Pennsylvania to a Geoffrey account in New York.[1]

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[1] The net effect of this corporate structure has been the production of "nowhere" income that escapes all state income taxation. *See* Rosen, *Use of a Delaware Holding Company to Save State Income Taxes*, 20 Tax Adviser 180 (1989). One commentator has recognized such income as the "product of a divide and conquer strategy that some members of the corporate world have exercised effectively for decades." Corrigan, *Interstate Corporate Income Taxation—Recent Revolutions and a Modern Response*, 29 Vand. L. Rev. 623, 629 (1976). The strategy's effectiveness is unquestionable. In 1990, Geoffrey, without any full-time employees, had an

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Toys R Us began doing business in South Carolina in 1985 and has since then made royalty payments to Geoffrey based on South Carolina sales. In 1986 and 1987, Toys R Us deducted the royalty payments made to Geoffrey from its South Carolina taxable income. The South Carolina Tax Commission (Commission) initially disallowed the deduction, but later took the position that Toys R Us was entitled to the deduction and that Geoffrey was required to pay South Carolina income tax on the royalty income. The Commission also held that Geoffrey was required to pay the South Carolina corporate license fee.

Geoffrey paid the taxes under protest and filed this action for a refund, claiming, among other things, that it did not do business in South Carolina and that it did not have a sufficient nexus with South Carolina for its royalty income to be taxable here. The trial judge upheld the Commission's assessment of taxes against Geoffrey. Geoffrey appealed.

II. DISCUSSION

S.C. Code Ann. § 12-7-230 (Supp. 1992), pursuant to which both foreign and domestic corporations are taxed, provides:

> [E]xcept as otherwise provided, every foreign corporation transacting, conducting, doing business, or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income, to be determined as provided in this chapter. The term "transacting", "conducting", or "doing business", as used in this section, includes the engaging in or the transacting

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income of approximately $55 million and paid no income taxes to any state.

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of any activity in this State for the purpose of financial profit or gain.

Section 12-3-270 levies a tax on the income of foreign corporations "transacting, conducting, doing business, or having an income *within the jurisdiction of this State,*" which "includes," but is not limited to, "the engaging in or the transacting of any activity in this State for the purpose of financial profit or gain." We construe this language as extending to the limits of the constitution South Carolina's authority to tax foreign corporations. Here, Geoffrey contends that the Due Process Clause, U.S. Const. amend. XIV, § 1, and the Commerce Clause, U.S. Const. art. I, § 8, cl. 3, prohibit the taxation of its royalty income by South Carolina. We disagree.

A. *Due Process*

The Due Process Clause requires "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax," and that the "income attributed to the state for tax purposes must be rationally related to values connected with the taxing State." *Quill Corp. v. North Dakota,* —— U.S. ——, ——, 112 S.Ct. 1904, 1909-10, 119 L.Ed.2d 91, 102 (1992). Geoffrey argues that the Commission has failed to satisfy both of these requirements. We disagree.

The nexus requirement of the Due Process Clause can be satisfied even where the corporation has no physical presence in the taxing state if the corporation has purposefully directed its activity at the state's economic forum. *Quill,* —— U.S. at ——, 112 S.Ct. at 1909-10. 119 L.Ed.2d at 104. Geoffrey asserts that it has not purposefully directed its activities toward South Carolina. To support its position, Geoffrey points out that Toys R Us had no South Carolina stores when it entered into the Agreement and urges, therefore, that Toys R Us's subsequent expansion into South Carolina was unilateral activity that cannot create the minimum connection be-

tween Geoffrey and South Carolina required by due process.

In our view, Geoffrey has not been unwillingly brought into contact with South Carolina through the unilateral activity of an independent party. Geoffrey's business is the ownership, licensing, and management of trademarks, trade names, and franchises. By electing to license its trademarks and trade names for use by Toys R Us in many states, Geoffrey contemplated and purposefully sought the benefit of economic contact with those states. Geoffrey has been aware of, consented to, and benefitted from Toys R Us's use of Geoffrey's intangibles in South Carolina. Moreover, Geoffrey had the ability to control its contact with South Carolina by prohibiting the use of its intangibles here as it did with other states. We reject Geoffrey's claim that it has not purposefully directed its activities toward South Carolina's economic forum and hold that by licensing intangibles for use in South Carolina and receiving income in exchange for their use, Geoffrey has the "minimum connection" with this State that is required by due process. *See American Dairy Queen Corp. v. Taxation and Revenue Dep't*, 93 N.M. 743, 605 P.2d 251 (1979); *Aamco Transmissions, Inc. v. Taxation and Revenue Dep't*, 93 N.M. 389, 600 P.2d 841, *cert. denied*, 93 N.M. 205, 598 P.2d 1165 (1979).

In addition to our finding that Geoffrey purposefully directed its activities toward South Carolina, we find that the "minimum connection" required by due process also is satisfied by the presence of Geoffrey's intangible property in this State. Geoffrey's Secretary, a certified public accountant, agreed during cross examination that sales by Toys R Us in South Carolina create an account receivable for Geoffrey. In addition, the trial judge found that Geoffrey had a franchise in South Carolina.[2] That the

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[2] "In its simplest terms, a franchise is a license from the owner of a trademark or trade name permitting another to sell a product or service under that name or mark. More broadly stated, a 'fran-

presence of these intangibles is sufficient to sustain a tax is settled law. In *Virginia v. Imperial Coal Sales Co., Inc.*, 293 U.S. 15, 20, 55 S.Ct. 12, 14, 79 L.Ed. 171, 175 (1934), the United States Supreme Court stated:

> It is not the character of the property that makes it subject to such a tax, but the fact that the property has a situs within the state and that the owner should give appropriate support to the government that protects it. That duty is not less when the property is intangible than when it is tangible. Nor are we able to perceive any sound reason for holding that the owner must have real estate or tangible property within the state in order to subject its intangible property within the state to taxation.[3]

Geoffrey asserts that under the doctrine of *mobilia sequuntur personam*, the situs of its intangibles is its corporate headquarters in Delaware, not South Carolina. However, in *Mobil Oil Corp. v. Comm'r of Taxes of Vermont*, 445 U.S. 425, 100 S.Ct. 1223, 63 L.Ed.2d 510 (1980), the United States Supreme Court rejected the view that the constitution requires taxation of intangibles by allocation to a *single* situs, finding no adequate justi-

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chise' has evolved into an elaborate agreement under which the franchisee undertakes to conduct a business or sell a product or service in accordance with methods and procedures prescribed by the franchisor, and the franchisor undertakes to assist the franchisee through advertising, promotion, and other advisory services." *Black's Law Dictionary* 592 (5th ed. 1979). Geoffrey has not challenged the trial judge's finding that the Agreement created a franchise.

[3] Although the tax at issue in *Imperial Coal* was an *ad valorem* property tax imposed upon the accounts receivable of a Virginia corporation, we do not find that fact distinguishing. Authority to tax the property extends to income produced by the property. "That [a state] may tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it is wholly inadmissible." *Sheffer v. Carter*, 252 U.S. 37, 49-50, 40 S.Ct. 221, 225, 64 L.Ed. 445 (1920).

fication for preferring that rule over taxation by apportionment. The High Court concluded that:

> [a]lthough a fictionalized situs of intangible property sometimes has been invoked to avoid multiple taxation of ownership, there is nothing talismanic about the concepts of "business situs" or "commercial domicile" that automatically renders those concepts applicable when taxation of income from intangibles is at issue. The Court has observed that the maxim *mobilia sequuntur personam*, upon which these fictions of situs are based, "states a rule without disclosing the reasons for it.". . . The Court has also recognized that "the reason for a single place of taxation no longer obtains" when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction. . . . Even for property or franchise taxes, apportionment of intangible values is not unknown. . . . Moreover, cases upholding allocation to a single situs for property tax purposes have distinguished income tax situations where the apportionment principle prevails. (Citations omitted).

Id. at 445, 100 S.Ct. at 1235, 63 L.Ed.2d at 525-26. *See also Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 56 S.Ct. 773, 80 L.Ed. 1143 (1936) (intangibles may acquire a situs for taxation other than at the domicile of the owner if they have become integral parts of some local business); *Southern Express Co. v. Spigener*, 118 S.C. 413, 110 S.E. 403 (1920) (the situs of intangible property is within this State if the right afforded by it is exercised here); Dexter, *Taxation of Income from Intangibles of Multistate-Multinational Corporations*, 29 Vand. L. Rev. 401 (1976); J. Hellerstein & W. Hellerstein, *State Taxation*, Para. 9.08-.09 (2d ed. 1992). We reject Geoffrey's claim that its intangible assets are located exclusively in Delaware. Accordingly, we find that Geoffrey's purposeful direction of activity toward South Carolina as well as its possessing intangible property here pro-

vide a definite link between South Carolina and the income by Geoffrey from the use of its trademarks and trade names in this State.

We also find that the second prong of *Quill* test has been met. Contrary to Geoffrey's assertion, South Carolina has conferred benefits upon Geoffrey to which the challenged tax is rationally related. As the United States Supreme Court recognized in *Curry v. McCanless*, 307 U.S. 357, 365-66, 59 S.Ct. 900, 905, 83 L.Ed. 1339, 1347 (1939):

> Very different considerations, both theoretical and practical, apply to the taxation of intangibles, that is, rights which are not related to physical things. Such rights are but relationships between persons, natural or corporate, which the law recognizes by attaching to them certain sanctions enforceable in courts. The power of government over them and the protection which it gives them cannot be exerted through control of a physical thing. *They can be made effective only through control over and protection afforded to those persons whose relationships are the origin of the rights* . . . . Obviously, as sources of actual or potential wealth—which is an appropriate measure of any tax imposed on ownership or its exercise—*they cannot be dissociated from the persons from whose relationships they are derived.* (Citations omitted). (Emphasis added).

The real source of Geoffrey's income is not a paper agreement, but South Carolina's Toys R Us customers. Cf. *Avco Financial Services Consumer Discount Co. v. Director, Division of Taxation*, 100 N.J. 27, 494 A.2d 788 (1985). By providing an orderly society in which Toys R Us conducts business, South Carolina has made it possible for Geoffrey to earn income pursuant to the royalty agreement. *See, e.g., Allied Signal v. Comm'r of Finance*, 79 N.Y.2d, 588 N.E.2d 731, 580 N.Y.S.2d 696 (1991) (benefits afforded to an in-state corporation inure

to non-resident shareholders). That Geoffrey has received protection, benefits, and opportunities from South Carolina is manifested by the fact that it earns income in this state. *Accord Aamco*, 93 N.M. at 393, 600 P.2d at 845 (quoting *Besser Co. v. Bureau of Revenue*, 74 N.M. 377, 394 P.2d 141 (1964)). That the tax is rationally related to these protections, benefits, and opportunities is evidenced by the fact that the State seeks to tax only that portion of Geoffrey's income generated within its borders. Based on the foregoing reasons, we hold that the Due Process Clause does not prohibit South Carolina's taxation of Geoffrey's royalty income.

B. *Commerce Clause*

A tax will survive challenge under the Commerce Clause so long as it 1) is applied to an activity with a substantial nexus with the taxing state, 2) is fairly apportioned, 3) does not discriminate against interstate commerce, and 4) is fairly related to the services provided by the State. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 1079, 51 L.Ed.2d 326, 331 (1977). Relying on *Nat'l Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967), Geoffrey contends that it does not have a substantial nexus with South Carolina because it is not physically present in this state. In our view, Geoffrey's reliance on the physical presence requirement of *Bellas Hess* is misplaced.[4]

It is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there. The presence of intangible property alone is sufficient to establish nexus. *American Dairy Queen*,

[4] The U.S. Supreme Court recently revisited the physical presence requirement of *Bellas Hess* and, while reaffirming its vitality as to *sales and use taxes*, noted that the physical presence requirement had not been extended to other types of taxes. *Quill*, —— U.S. at ——, 112 S.Ct. at 1914, 119 L.Ed.2d at 108.

93 N.M. at 747, 605 P.2d at 255. *See also Int'l Harvester Co. v. Wisconsin Dep't of Taxation*, 322 U.S. 435, 441-442, 64 S.Ct. 1060, 1063-64, 88 L.Ed. 1373, 1379 (1944) (a state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are within the protection of the state and entitled to the numerous other benefits which its [sic] confers); J. Hellerstein & W. Hellerstein, *supra*, at 6.08 (any corporation that regularly exploits the markets of a state should be subject to its jurisdiction to impose an income tax even though not physically present). A taxpayer who is domiciled in one state but carries on business in another is subject to taxation measured by the value of the intangibles used in his business. *Curry*, 307 U.S. at 368, 59 S.Ct. at 906, 83 L.Ed. at 1348. We hold that by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a "substantial nexus" with South Carolina.[5]

Geoffrey finally contends that even if it is subject to South Carolina income tax, all of its royalty income would be allocated or apportioned to Delaware pursuant to S.C. Code Ann. §§ 12-7-1120(5) or 12-7-1140 (1977 and Supp. 1992). These statutes are inapplicable to the income received by Geoffrey. Section 12-7-1120(5) allocates gains or losses from the sale of intangible personal property not connected with the business of the taxpayer, other than any intangible personal property held for sale to customers in the regular course of business. Section 12-7-1140 apportions the income of taxpayers whose principal business in this State is (a) manufacturing or any form of collecting, buying, assembling or

[5] Further discussion of the remaining requirements of the Commerce Clause is unnecessary. Our Due Process analysis of the benefits conferred upon Geoffrey applies with equal force here and need not be repeated. Moreover, Geoffrey raised no constitutional claim that the challenged tax is not fairly apportioned or discriminates against interstate commerce.

processing goods and materials within this State, or (b) selling, distributing or dealing in tangible personal property within this State.

In conclusion, we hold that the taxation of Geoffrey's royalty income pursuant to section 12-7-230 is not prohibited by the Due Process Clause or the Commerce Clause of the United States Constitution. Our finding that Geoffrey may be taxed pursuant to section 12-7-230 settles the question whether Geoffrey must pay the corporate license fee. All corporations subject to section 12-7-230 are required to do so. *See* S.C. Code Ann. §§ 12-19-20, 12-19-70 (1977 & Supp. 1992). The order of the trial judge is

AFFIRMED.

CHANDLER, FINNEY, TOAL and MOORE, JJ., concur.

APPENDIX B

STATE OF SOUTH CAROLINA)
)
COUNTY OF GREENVILLE)

IN THE COURT OF COMMON PLEAS

Case No. 90-CP-23-3939

GEOFFREY, INC.,
Plaintiff,

vs.

SOUTH CAROLINA TAX COMMISSION,
Defendant.

FINAL ORDER

The dispute in this matter has given rise to several issues. After a review of the prior Summary Judgment Motion, which was postponed by Judge McGowan, Jr., the issues raised in this action will be discussed along with the relevant facts surrounding each issue.

A. Previous Partial Summary Judgment Motion.

The Partial Summary Judgment Motion was heard by Judge Frank McGowan, Jr. and resulted in the following order dated December 21, 1990:

> Defendant South Carolina Tax Commission's Motion For Partial Summary Judgment is denied at this time. Further inquiry must be had for legal and/or factual issues.

The basis for the Tax Commission's Partial Summary Judgment Motion was that the Complaint set forth five

issues in five causes of action, but in the Tax Commission's view, three of the issues were not raised in the administrative hearing held by the South Carolina Tax Commission. Thus, the argument to this court was that these alleged new issues are improper since the taxpayer failed to exhaust its administrative remedies. At the hearing before this court the parties argued this matter.

1. Issues Asserted As Not Raised Below.

There are three issues which the Tax Commission asserts the taxpayer did not raise at the administrative level. The asserted first new issue is that taxing the taxpayer violates Due Process because the taxpayer has insufficient connections to South Carolina. The asserted second new issue is that taxing the taxpayer's income violates Interstate Commerce since the imposition of tax against Geoffrey is unreasonable and impermissible. The asserted third new issue which the Tax Commission says is not raised at the administrative level is the taxpayer alleges that even if the taxpayer were properly taxed by the South Carolina Tax Commission, the income is allocated away from South Carolina to Delaware under S.C. Code Ann. §§ 12-7-1120 and 12-7-1130 (1976).

2. Conclusions As to Issues Raised Below.

After a review of the arguments before this court, it is the court's finding that there has not been a failure to exhaust administrative remedies. The three issues in dispute are properly before this court and all issues are addressed on their merits.

B. Issues Raised By The Pleadings.

Five issues are raised. First, the taxpayer alleges that its income is not subject to tax under § 12-7-230. Second, the Complaint asserts the imposition of the tax by § 12-7-230 violates Due Process. The basis for this assertion is that the taxpayer has insufficient connections to South

Carolina, and further, the income South Carolina seeks to tax has insufficient connections to South Carolina. The third issue raised is whether the imposition of tax violates Interstate Commerce since imposing the tax in the words of the Complaint is "unreasonable" and "impermissible." The fourth issue is that if the taxpayer's income is taxable, is the income taxable in South Carolina, or rather, is such allocated to Delaware by § 12-7-1120 or § 12-7-1130. The final issue is that the taxpayer alleges the license fee imposed on the taxpayer is improper for the same four reasons identified above. In other words, if the income tax is proper, then the parties agree that the license fee is proper. Each of these issues is addressed below.

1. Tax Under § 12-7-230.

a. The Statutory Language.

The relevant language of § 12-7-230, the statute that imposes the income tax on foreign corporations, is as follows:

> . . . every foreign corporation transacting, conducting, doing business or having an income within the jurisdiction of this State, whether or not such corporation be engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to six percent of a proportion of its entire net income, to be determined as provided in this chapter. The term "transacting," "conducting," or "doing business," as used in this section shall include the engaging in or the transacting of any activity in this State for the purpose of financial profit or gain.

Satisfying two elements will bring a taxpayer within this statute and it is the finding of this court that each of those elements is met here. First, the taxpayer must

be a foreign corporation. There is no dispute over this element since the taxpayer is a corporation chartered in Delaware in 1984.

The second element, and the one which is in dispute, is that the corporation must fall within one of four broad categories. It must be transacting, conducting, doing business, or having an income within South Carolina.

The language used by the General Assembly and the legislative history make it clear that this statute is to have a wide scope. The literal language of the statute supports the view that this statute is intended to be all encompassing. First, the statute does not exempt a taxpayer just because the taxpayer has income or activities taking place in more than one state. The statute taxes income "whether or not the corporation is engaged in or the income is derived from intrastate, interstate, or foreign commerce." Second, the General Assembly further emphasized the breadth of this statute by explaining that the four broad categories identified above "include[] the engaging in or the transacting of any activity in this State for the purpose of financial profit or gain." Third, when the statute sets out a meaning for the four broad categories it uses the word "includes." Thus, the meaning given by the General Assembly was not limited to the definition alone, but rather, such categories should cover other activities of a taxpayer not mentioned specifically in the statute. Additionally, the definition used by the statute says that a taxpayer is within the imposition statute if there is "any activity in this state." In other words, the degree or extensiveness of the activity is not a factor, but rather, the mere presence alone in the state of the activity is enough to bring the taxpayer within the imposition.

Not only is the language of the statute broad but the legislative history of the statute shows an increasingly broad approach to taxing parties who have the benefit of South Carolina's resources and protection. The 1927

Acts and Joint Resolutions, Act 1, p. 1, set the original tax on corporations and the only language used was that of "doing business" in South Carolina, and thus, established the first category of activities subject to tax. That statute was expanded in the 1930 Acts and Joint Resolutions, Act 803, p. 1339, by adding to the original "doing business", the second category of activities by using the phrase ". . . or having an income within . . ." South Carolina. This language was again expanded a third time by the 1958 Acts and Joint Resolutions, Act 693, p. 1666. There the third and fourth categories of activities were introduced as being "transacting" or "conducting" business in South Carolina. Further, to make its point clear, the General Assembly in Act 693 explained that the terms "transacting, conducting or doing business" include "any activity in this state for the purpose of financial gain."

b. Transacting, Conducting, Doing Business, Or Having An Income Within South Carolina.

The statutory language in question has not been construed by any decision of our Appellate Courts, and thus, there is no judicial authority on how the language is to be applied. However, essentially, the inquiry becomes one of deciding if the taxpayer's activity seeks a profit or financial gain and does that activity take place in South Carolina. This court concludes the facts, the longstanding administrative practice of the Tax Commission, and the case law all demonstrate that under this inquiry, the taxpayer here is within the imposition statute of § 12-7-230.

The facts show that the taxpayer's activities were for the purpose of seeking a profit and a financial gain. The taxpayer's License Agreement demonstrates how the taxpayer's total activity in South Carolina is aimed at "the purpose of financial profit or gain." At Article III, the agreement grants to the taxpayer a royalty of 1% on

the net sales of Toys "R" Us. Clearly, there is no royalty unless there is a sales activity in South Carolina. The taxpayer's trademark is displayed on all six of the Toys "R" Us retail stores in the state as well as on the merchandise and in the advertisements that enable it to produce the royalties. To ensure that the trademark remains profitable in South Carolina, the taxpayer is contractually allowed to defend the trademark against infringements. Thus, the evidence establishes that the activity of Geoffrey is to derive a profit or financial gain.

It is also established that the profit seeking activity takes place in South Carolina. The profitable activity can take place nowhere else other than where the trademark is displayed. It is at that location that the trademark generates sales and those sales generate royalties for the taxpayer. In short, since the sales that produce the royalty are in South Carolina, the profit making activity is in South Carolina. This view is supported both by the longstanding administrative practice of the Tax Commission as well as by the case law of South Carolina.

The Tax Commission's longstanding administrative practice is evidenced by numerous taxpayers whose sole activities in South Carolina are limited to the single activity that earns the income. For example, finance companies are taxed in South Carolina based on whether the borrower resides in this state. Engineers and architects are taxed here if they perform any services in the state. Law firms and accounting firms are subject to tax based on where they perform the services for which they are paid. Restaurant franchise companies that have no activity in this state except the presence of their franchise name from which they derive their income are subject to tax in South Carolina. The longstanding administrative practice of an agency charged with enforcement of specialized statutes are [sic] not to be overturned in the absence of compelling reasons. *Multi-Cinema Ltd. v. South*

Carolina Tax Com'n., 292 S.C. 411, 357 S.E.2d 6 (1987). Here there are no such compelling reasons.

Case law supports the administrative practice. In *Lockwood Greene Eng. v. South Carolina Tax Com'n.*, 293 S.C. 447, 361 S.E.2d 346 (1987), the activity that earned the income was the engineering activity. The court found that since the engineer rendered his services where he physically worked, then the income derived from those services was part of the receipts of the state in which the engineer was located. Thus, work performed in South Carolina was held to be South Carolina receipts.

Here, just as in *Lockwood Greene,* the facts show that the activity that produces the income is activity which takes place in South Carolina. Accordingly, the facts show the taxpayer's activities are for the purpose of financial profit or gain. Additionally, the facts, longstanding administrative practice and case law also show the profit activity occurs in South Carolina. Thus, the taxpayer is subject to tax under § 12-7-250.

2. Due Process And Interstate Commerce.

The broad general principles governing Due Process have been well-established.

> . . . the Due Process Clause of the Fourteenth Amendment imposes two requirements: a "minimal connection" between the interstate activities and the taxing State, and a rational relationship between the income attributed to the State and the intrastate values of the enterprise. [cites omitted]. The requisite "nexus" is supplied if the corporation avails itself of the "substantial privilege of carrying on business" within the State; and "[t]he fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction. [cites omitted]

Mobil Oil Corp. v. Com'r. of Taxes of Vermont, 100 S. Ct. 1223, 1231 (1980).

Thus one issue under Due Process is whether the facts show that the appropriate level of activity exists in South Carolina so that there is "nexus" between the royalty activities and South Carolina. A second issue under Due Process is whether a rational relationship exists between the amount of income attributed to South Carolina and the activities in South Carolina. The "nexus" question is determined on the facts based on the extent of activity in South Carolina. The "rational relationship" question is determined based on how South Carolina determines the tax liability of the taxpayer. In other words, the method for determining the tax liability must be based on some rational method connected with the taxpayer's activity in South Carolina.

a. Nexus For Due Process And Interstate Commerce.

The United States Supreme Court has found that the requirement for satisfying a "minimal connection" for nexus is the same for both Due Process and Interstate Commerce. *Trinova Corp. v. Michigan Department of Treasury,* 111 S.Ct. 818 (1991); *Amerada Hess Corp. v. Director, Division of Taxation,* 109 S.Ct. 1617 (1989). The broad test applied to determine whether nexus exists in a state is simply one of asking whether the state has provided some protection, opportunity, or benefit for which it can ask a return. *Wisconsin v. J. C. Penney Co.,* 61 S.Ct. 246 (1940). The exploitation of a state's market or the presence of the taxpayer's intangible property in the state are [sic] each by themselves sufficient to satisfy the nexus requirement of Due Process. In the instant matter, both exploitation of South Carolina's market and the presence within South Carolina of intangible property are demonstrated.

i. Exploitation Of South Carolina's Market By The Taxpayer.

The application of the nexus test does not turn on the physical presence in the state of the taxpayer. Rather, the critical element is the taxpayer's effort to exploit the economic market provided by the State. This view has been succinctly stated by the United States Supreme Court in *Tyler Pipe Industries, Inc. v. Washington State Department of Revenue*, 107 S.Ct. 2810, 2821 (1987):

> . . . the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.

The exploitation of a state's market has been held to be a sufficient basis upon which to find a valid nexus within the meaning of Due Process. In *American Refrigerator Transit Co. v. State Tax Commission*, 395 P.2d 127 (1964), the taxpayer, a lessor of railroad cars, was held liable for income tax in a state in which it did no business except that its lessees used the leased property in the state. In upholding the tax, the Oregon Supreme Court stated the following:

> The connection between the taxing state and the out-of-state taxpayer necessary to establish nexus is essentially an economic rather than a physical relationship . . .
>
> The nexus exists whenever the corporation takes advantage of the economic milieu within the state to realize a profit. The state is entitled to tax if the benefits it provides are a substantial economic factor in the production of the taxpayer's income. These benefits are found in the maintenance of conditions essential to the production or marketing of goods. They may be realized simply in the protection of the taxpayer's property used in the production of income.

> . . . Nexus may be found even where neither property nor personnel of the taxpayer is employed within the taxing state if it can be said that the state substantially contributes to the production of the taxpayer's income.

Under the facts of the instant case, the taxpayer has sought to exploit South Carolina's market for its gain. Here the trademark was continually and systematically used to exploit South Carolina's retail markets through its display in the six retail locations in the state. The trademark is used in all print and media advertising campaigns. To ensure the market remained favorable to the trademark's ability to generate royalties, the taxpayer may defend the trademark against infringement in South Carolina. Further, Article VI at 6.3 allows the taxpayer further control of the activity by giving the taxpayer the right of approval over the advertising and products sold by Toys "R" Us.

ii. The Taxpayer's Intangibles Are Present In The State.

The presence of property in a state from which the taxpayer derives its income and over which the state provides protection is a significant contact which satisfies the minimal contact required by Due Process. *Northwestern States Portland Cement Co. v. Minnesota* and *Williams v. Stockham Valves & Fittings, Inc.*, 79 S.Ct. 357 (1959). In the instant case, the taxpayer has property in South Carolina from which it derives income and over which South Carolina provides protection. Therefore no violation of the nexus principle is found here.

The property located in South Carolina consists of intangible property in two distinct forms: first, a franchise and second, debts owed to the taxpayer arising from the franchise. The nature and location of these intangibles are discussed below.

The taxpayer's activities have created a franchise and a debt receivable. A franchise is defined as the license

from the owner of a trademark or trade name permitting another to sell a product under that trade name or permitting another to sell a product or service under the mark. *Black's Law Dictionary*, 592 (5th ed. 1979). Here the taxpayer is the owner of several trademarks and the taxpayer, by a written agreement, has permitted Toys "R" Us to utilize that trademark. Thus, the agreement between the taxpayer and Toys "R" Us has created a franchise. Further, additional property was created by the taxpayer through the owning of accounts receivable generated by the franchise. Article V at section 5.1 states that the royalties are to be paid annually in February, but under 5.2, the payments accrue on a monthly basis. Thus, until the annual payment in February, there is a growing accounts receivable generated by the franchise.

Having identified the income-producing property created by the taxpayer's activity, it is necessary to find the location of that property. If the location is in South Carolina, such presence is sufficient minimal contact to satisfy Due Process.

It is established that an intangible has a location of the domicile of the owner of the property until that property has been integrated with an activity carried on in another state. At that point, the taxable situs is in the state where the activity is conducted. *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936). This point is well stated in *Tuition Plan of New Hampshire v. Director, Division of Taxation*, 4 N.J. Tax 470 (1982).

> . . . the situs of an intangible and the place where income is earned are one and the same issue.

In the instant case it is clear that the income is earned in South Carolina. The purpose of the license agreement is to encourage sales in South Carolina. In fact, whenever a sale is made it is because of the franchise agreement which allows the seller to use the well known and respected Toys "R" Us symbol. The license is in South Carolina since it is integrated with the business carried on here. The same is true with the debts receivable by

the taxpayer from Toys "R" Us. Those debts are created solely as a result of the license agreement. The debt is just as integral to the activities in South Carolina as is the license agreement. In short, the intangibles are integrated with the royalty producing activity in South Carolina.

b. The Apportionment Formula.

Compliance of an apportionment formula with Due Process and Interstate Commerce is found by applying the following test set out by the United States Supreme Court in *Container Corporation of America v. Franchise Tax Board,* supra.

> . . . an apportionment formula must, under both the Due Process and Commerce Clauses, be fair. See Exxon Corp., supra, 447 U.S. at 219, 227-228, 100 S.Ct., at 2118, 2122-2123; Moorman Mfg. Co., 437 U.S. at 272-273, 98 S.Ct. at 2343-2344; Hans Rees' Sons, Inc., 283 U.S. at 134, 51 S.Ct. at 389. The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business income being taxed. The second and more difficult requirement is what might be called external consistency—the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated. The Constitution does not 'invalidat[e] an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State . . .' Moorman Mfg. Co., supra, 437 U.S. at 272, 98 S.Ct. at 2344 (emphasis added). See Underwood Typewriter Co., 254 U.S. at 120-121, 41 S.Ct. at 46-47. Nevertheless, we will strike down the application of an apportionment formula if the taxpayer can prove 'by "clear and cogent evidence" that the income attributed to the State is in fact "out of all

> appropriate proportions to the business transacted . . . in that State," [Hans Rees' Sons, Inc.] 283 U.S. at 135, 51 S.Ct. at 389, or has "led to a grossly distorted result," [Norfolk & Western R. Co. v. State Tax Comm'n., 390 U.S. 317, 326, 88 S.Ct. 995, 1001, 19 L.Ed.2d 1201 (1968)].' Moorman Mfg. Co., supra, 437 U.S. at 274, 98 S.Ct. at 2345.

These tests must be applied to South Carolina's apportionment statutes.

i. Internal Consistency.

The internal consistency test is simply one part of a two-part test of seeking fairness. The "internal" part of the test seeks only to determine if the formula itself is capable of dividing the "income pie" into slices that account for 100% of the income. The internal consistency test is one of asking "can the formula work" rather than asking "does the formula work." (The latter is essentially the "external consistency" part of the test.) Such being true, it is not relevant to the internal consistency test what another taxing jurisdiction may or may not be doing in taxing Geoffrey's royalty income.

The proper application of the test is to apply the test as though every jurisdiction, foreign and domestic, used South Carolina's apportionment formula. If all jurisdictions used the identical gross receipts formula South Carolina uses, only 100% of the taxpayer's income is taxed. This is true since each jurisdiction would receive a portion of the income based only on the percentage of the gross receipts from within their state as required by § 12-7-1190. Accordingly, no more than 100% of the income could ever be taxed.

ii. External Consistency.

The test of fairness under the Due Process and Commerce Clauses also requires satisfying an external consistency test which seeks to show that the apportionment

factors "reflect a reasonable sense of how income is generated." *Container Corp.*, 463 U.S. at p. 169. In this formulation of the test, the court underscores the view that the in-state factors in the formula are only to be reasonable. Exactness is not a requirement. In fact, to develop the view that rough approximations are valid, the *Container* court identified the outer limits of what is reasonable by expressing the following at 103 S.Ct. at p. 2942:

> . . . we will strike down the application of an apportionment formula if the taxpayer can prove 'by "clear and cogent evidence" that the income attributed to the State is, in fact, "out of all appropriate proportions to the business transacted . . . in that State," [Hans Rees' Sons, Inc.] 283 U.S. at 135, 51 S.Ct. at 389, or has "led to a grossly distorted result," [Norfolk & Western R. Co. v. State Tax Comm'n., 390 U.S. 317, 326, 88 S.Ct. 995, 1001, 19 L.Ed.2d 1201 (1968)].' Moorman Mfg. Co., supra, 437 U.S. at 274, 98 S.Ct. at 2345.

In the instant case the gross receipts formula does "reflect a reasonable sense of how income is generated." The sole source of income in South Carolina by the taxpayer is that derived from royalties. The amount of those royalties is the very measure that South Carolina uses to determine the percentage of the taxpayer's net income. In other words, the taxpayer does not pay tax on its total income. Rather, it pays tax based on the percentage of its total royalties that are produced in South Carolina. Thus, if there are no royalties produced in South Carolina there are no taxes due and if only 10% of the taxpayer's royalties are in South Carolina, the taxpayer pays tax on 10% of its net income. Such a formula is inherently "reasonable".

3. Allocation Under § 12-7-1120 or § 12-7-1130.

The allocation provisions of § 12-7-1120 require that income from certain classes of property must be allocated

to a particular location. The taxpayer argues that its royalty income must be allocated to Delaware under some provision of § 12-7-1120. This position is incorrect.

There is only one reference in 12-7-1120 to allocating royalty income and that section in pertinent part is as follows:

> . . . royalties received from tangible property, . . . less all related expenses, shall be allocated to the state in which the property was located at the time the income was derived.

This section pertains to royalty income from "tangible property." Here the property producing the royalty income is a license and such property is unquestionably intangible property. Thus, § 12-7-1120 does not allocate the royalty income at all.

Further, even if this section were to apply the royalty income here would be allocated in full to South Carolina rather than to Delaware. Such is true since the income is taxed where the property that produced it was located. As developed previously in this Order, the license that generated the royalty here in dispute is located in South Carolina since the license is an integrated part of the taxpayer's activities here.

Finally, § 12-7-1130 does not allocate the royalty income here in dispute. That section allocates income only when the income in question is from "any other investments" not covered in § 12-7-1120. In other words, the activity under review must be an investment activity and the income from that investment activity must not be of the type already allocated by § 12-7-1120.

Here the royalty income is not that generated by an investment activity. Rather, it is clear that the taxpayer is carrying on a business of producing royalty income by the active management and exploitation of numerous markets. Because of such, none of the royalty income is allo-

cated to Delaware. Rather, the taxpayer's net income is taxed on an apportionment basis under § 12-7-1190.

Finally, § 12-7-1130 allocates the income to the situs of the investment. Here the situs of the investment is the place where the income is earned, i.e. South Carolina. Thus, even application of § 12-7-1130 does not help the taxpayer.

4. License Tax.

The license tax is determined under the same method as the tax on income. Thus, this court holds the license tax is also proper for the same reasons the income tax is proper.

C. Conclusion

Based on the facts, the longstanding administrative interpretation, and the case law, Geoffrey is carrying out activities in South Carolina for the purpose of profit and financial gain so as to be taxable under § 12-7-230. The activities in and contacts to South Carolina are of such a magnitude that South Carolina's taxing of a small portion of the taxpayer's net income does not violate Due Process or Interstate Commerce. Further, §§ 12-7-1120 and 12-7-1130 are inapplicable to the taxpayer. There is no basis for allocating the income of the taxpayer to Delaware. Accordingly, the court upholds the Tax Commission's assessment and dismisses the taxpayer's Complaint.

AND IT IS SO ORDERED.

/s/ Larry R. Patterson
LARRY R. PATTERSON
Judge
Thirteenth Judicial Circuit

Greenville, South Carolina
February 27, 1992.

APPENDIX C

STATE OF SOUTH CAROLINA
BEFORE THE
SOUTH CAROLINA TAX COMMISSION

In Re:

A Finding Concerning The Income Tax Liability Of Toys "R" Us For Tax Years 1986 And 1987 And For Geoffrey, Inc., For Tax Years 1986 And 1987.

FINDINGS OF FACT

Toys "R" Us, Inc. (Toys), incorporated under the laws of Delaware in 1928, is a multistate corporation engaged in the retail sale of toys and children's apparel throughout South Carolina, the United States and in several foreign countries. Toys began doing business in South Carolina in 1985.

In 1984, Toys created a wholly owned subsidiary, Geoffrey, Inc. (Geoffrey). The registered trademarks (Geoffrey the Giraffe, Toys "R" Us, Kids "R" Us and "R" Us) of Toys were then transferred to the subsidiary in a tax free transaction under Internal Revenue Code Section 351. A license agreement was then executed in which Toys agreed to pay Geoffrey a royalty of 1% of net sales for the right to use these trademarks in Toys' business operations. These royalty payments have been deducted from apportionable income by Toys. The license agreement requires that Geoffrey register and renew all trademark registrations and protect the trademarks from trademark infringers. Geoffrey is a Delaware holding company and has not filed or paid income tax to South Carolina.

CONCLUSIONS OF LAW

We find and conclude the royalty payments to Geoffrey by Toys are deductible by Toys as part of the computation to arrive at Toy's [sic] apportionable income. We, however, find that Geoffrey has sufficient nexus in South Carolina to require the filing of a return and the payment of South Carolina income tax on its income.

Geoffrey is "doing business" in South Carolina and is subject to income tax here. Section 12-7-230 provides the Commission with broad authority to impose an income tax on foreign corporations engaged in interstate commerce:

> "Every foreign corporation transacting, conducting, doing business or having an income within the jurisdiction of this State, whether or not such corporation be engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to six percent of a proportion of its entire net income, to be determined as provided in this chapter. *The term 'transacting,' 'conducting' or 'doing business' as used in this section shall include the engaging in or transacting of any activity in this state for the purpose of financial profit or gain.*" (Emphasis added)

Geoffrey is engaged in business in this State for the purpose of financial profit or gain. The Toys "R" Us trademark is continually and systematically used to exploit South Carolina's retail markets. The trademark is displayed in and on all six South Carolina retail locations. The mark is used in all print and media advertising campaigns. Geoffrey is contractually obligated to investigate and defend the trademarks against infringement in this State. Geoffrey received royalties of $177,000 from Toys' South Carolina activities during the audit period for use of the mark.

We find that the license agreement between Toys and Geoffrey is present in this State since that agreement is

the means by which Geoffrey derives its income here. See *In re Heftal Broadcasting Honolulu, Inc.*, 554 P.2d 242 (1976). Further, when an intangible is integrated with a business in the State, the situs of the intangible and the place where the income is earned are one and the same. *Tuition Plan of N.H. v. Director, Div. of Taxation*, 4 N.J. Tax 470 (1982).

We note that *Western Acceptance Co. v. State Dept. of Revenue*, 472 So.2d 497 (1985), also supports our view. There, Western Auto transferred their customer receivables to a wholly owned subsidiary, Western Acceptance. Acceptance owned no property other than cash and receivables and had no employees or offices in or out of Florida. All business functions of the subsidiary were carried out by employees of the parent.

The Court ruled that Western Acceptance had sufficient contacts with the state to be "doing business" subject to taxation. Acceptance's activities in substance were conducted by and were the direct result of Western Auto's activities. Acceptance was found to be doing business in Florida because, "but for" Western Auto's activities on Acceptance's behalf, Acceptance could not have conducted any business or earned any income.

An analysis of the pro forma tax returns of Geoffrey reveals that Geoffrey likewise has no full time employees and does not own any property. The legal services for trademark infringement are provided by outside counsel. Here, as in the Western Acceptance decision, the income of the subsidiary is a direct result of the efforts of the parent. Geoffrey is likewise subject to state income taxation.

The final issue concerns Toys' method for computing expenses related to dividend income. Toys received $30,000,000 in dividend income in each of the years under examination. All of this income is allocated outside of South Carolina. For the year ending February,

1983, $11,000,000 of these dividends were paid by Geoffrey.

Related expenses were calculated as follows using the "DC Formula":

	FYE 2/1/86	FYE 2/1/87
Investment Assets	$ 323,797,161	$ 184,777,606
Total Assets	$1,004,834,521	$1,169,214,230
Ratio	32.2239%	15.8036%
Interest Expense	$ 22,593,962	$ 23,934,681
Related Expense	$ 7,280,656	$ 3,782,541

Section 12-7-1120(2) allocates the dividends "less related expenses." We are unable to find where the taxpayer has demonstrated that the interest expense is related to specific items. Thus, we are required to arrive at a reasonable method of sharing the interest expense between investment assets and the taxpayer's other assets. We find the "DC formula" to be appropriate and thus uphold the Division's position.

Finally, a penalty was imposed due to Geoffrey's delinquency. Since we have the authority to waive penalties and since this is the first opportunity Geoffrey has had to fully understand our law on taxability of income earned through the use of trademarks, we waive the penalty involved.

AND IT IS SO FOUND AND ORDERED.

SOUTH CAROLINA TAX COMMISSION

/s/ S. Hunter Howard, Jr.
S. HUNTER HOWARD, JR.
Chairman

/s/ A. Crawford Clarkson, Jr.
A. CRAWFORD CLARKSON, JR.
Commissioner

Columbia, South Carolina
July 20, 1990

APPENDIX D

[SEAL] MULTISTATE TAX COMMISSION
National Nexus Program

August 20, 1993

Toys R Us
Mr. John Salvia
Tax Manager
395 West Passaic Street
Rochelle Park, NY 07662

Dear Mr. Salvia:

The Multistate Tax Commission National Nexus Program is an organization formed by a group of states in an effort to increase state tax compliance. One of the activities of the Nexus Program is to help its member states identify multistate companies that may have compliance problems. The Nexus Program also provides registration information as a mechanism for these companies to voluntarily resolve potential income/franchise tax liabilities in several states at one time.

We understand that your company and Geoffrey, Inc. may be transacting, conducting, doing business, or deriving income within the jurisdiction of various states. Many states impose income tax nexus based on minimal activities (including the licensing of intangible property rights) performed within the State. As a result of these activities, some states may require your company and/or its subsidiaries to register and remit state income/franchise taxes.

To help us determine whether further inquiry is appropriate, we request that you complete the enclosed Nexus Questionnaire and return it to me in the enclosed envelope by September 20, 1993. If you fail to respond by the above due date, or if your responses are inadequate, we may request that member states authorize a through [sic] investigation.

I have also enclosed information about our Nexus Program, including information that describes in some detail our voluntary settlement process. If you would like to discuss whether your company might be eligible for a voluntary settlement with our Program states or if you have any other questions, please contact me directly at 202-508-3807.

Sincerely,

/s/ Alice J. Davis
ALICE J. DAVIS
Director

Enclosures

mg/wp51/toysrus.cov

APPENDIX E

STATUTORY PROVISIONS

Sec. 12-7-230. Tax on corporations.—(A) Every corporation organized under the laws of this State, whose entire business is transacted or conducted within this State, shall make a return and shall pay annually an income tax equivalent to five percent of the entire net income received by such corporation during the income tax year, and except as otherwise provided, every corporation organized under the laws of this State, doing or transacting business partly within and partly without this State, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income to be determined as provided in this chapter, and except as otherwise provided, every foreign corporation transacting, conducting, doing business or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax equivalent to five percent of a proportion of its entire net income, to be determined as provided in this chapter. The term "*transacting*," "*conducting*," or "*doing business*," as used in this section shall include the engaging in or the transacting of any activity in this State for the purpose of financial profit or gain.

(B) In the case of any corporate taxable year beginning before January 1, 1989, the rate imposed by subsection (A) does not apply and the following rates apply:

(1) six percent for corporate taxable years beginning before 1988,

(2) five and one-half percent for corporate taxable years beginning in 1988.

Sec. 12-7-1190. Computations in regards to remaining income of other taxpayers.—If the principal profits or income of a taxpayer, other than those described in former 1962 Code § 65-256 or § 12-19-100, are derived from sources other than manufacturing, producing, collecting, buying, assembling, processing or selling, distributing or dealing in tangible personal property such taxpayer shall make returns and pay annually an income tax upon a proportion of its remaining net income computed on the basis of the ratio of gross receipts from within this State during the income year to the total gross receipts of such year within and without the State.

Sec. 12-19-70. Imposition of license tax on corporations generally; rate; minimum tax; time payable.—In addition to all other license taxes or fees or taxes of whatever kind, every corporation required to file the report by Section 12-19-20 except the corporations enumerated in Section 12-19-100, shall pay to the Commission at the time of filing the report as required by Section 12-19-20 an annual license fee of fifteen dollars plus one mill on each dollar paid to the capital stock and paid in as surplus of the corporation as shown by the records of the corporation on the first day of the income year next preceding the date of filing the report. In no case may the license fee provided by this section be less than twenty-five dollars. The license fee provided for by this section must be paid at the time of filing the report pursuant to the provisions of Section 12-19-20. The phrase "*paid in as surplus*" for the purposes of Chapter 19, Title 12, means the entire surplus of a corporation other than its earned surplus as defined below, and includes any charges against earned surplus reflected in the balance sheet except charges for reserves.

For purposes of this section, "*earned surplus*" means that portion of the surplus of a corporation equal in amount to the balance of its net profits, income, gains, and losses from the date of incorporation, or from the

latest date when a deficit was eliminated by application of its capital surplus, after deducting subsequent distributions to shareholders and transfer to stated capital and capital surplus to the extent that such distribution and transfers are made out of earned surplus. Unrealized appreciation of assets shall not be included in earned surplus.

Supreme Court, U.S.
FILED
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OFFICE OF THE CLERK

No. 93-520

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

GEOFFREY, INC.,

Petitioner,

v.

SOUTH CAROLINA DEPARTMENT
OF REVENUE AND TAXATION,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Does a taxpayer lack the substantial nexus required by the Commerce Clause or the minimum connection required by the Due Process Clause when the taxpayer conducts an ongoing and continuous business activity in the taxing state?

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No. 93-520

IN THE

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OCTOBER TERM, 1993

GEOFFREY, INC.,

Petitioner,

v.

SOUTH CAROLINA DEPARTMENT
OF REVENUE AND TAXATION,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of South Carolina

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION

Respondent, South Carolina Department of Revenue and Taxation (Department of Revenue), respectfully requests that Petitioner's request for a Writ of Certiorari to the South Carolina Supreme Court be denied.

OPINIONS BELOW

The Order of the Circuit Court (Petitioner's Appendix 12a-27a) is not officially reported. The Opinion of the Supreme Court of South Carolina (Petitioner's Appendix 1a-11a) is not yet reported.

JURISDICTION

The jurisdiction in this Court is found at 28 U.S.C. Section 1257(a).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

U.S. CONST. art. I, Section 8, cl. 3 states in part the following:

> The Congress shall have Power...[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

The U.S. CONST. amend XIV, Section 1 states in part the following:

> No State shall . . . deprive any person of life, liberty, or property, without due process of law.

STATEMENT OF THE CASE

1. Procedural Background

This action was brought by Geoffrey as a suit to recover income taxes paid under protest with the amount in dispute being $10,612 in income tax, $44 in license tax and $4,932 in interest. The action was begun on September 18, 1990, by the filing of a Summons and Complaint.

The Complaint sought a refund and asserted five causes of action. The first alleged the taxpayer had no income subject to tax in South Carolina since it was not within the jurisdiction of the State as set out in S.C. Code Ann. Section 12-7-230 (Supp. 1992). The second and third asserted respectively that imposing a tax violated Due Process and Interstate Commerce. The fourth specifically alleged that if the taxpayer were subject to South Carolina's taxing statutes, then S.C. Code Ann. Sections 12-7-1120 (Supp. 1992) and 12-7-1130 (1976) allocated the royalty income to Delaware. The fifth cause of action asserted the taxpayer was not liable for a license fee to South Carolina. The Department of Revenue answered and denied the taxpayer was due a refund.

The matter was heard by the Trial Court on November 19, 1991, in the Circuit Court of Greenville County. The Trial Court issued its Order on February 27, 1992, upholding the imposition of the income tax and the license tax. The taxpayer filed its Notice of Appeal on March 27, 1992. On April 7, 1993, the South Carolina Supreme Court heard the matter, and on July 6, 1993, issued its Opinion upholding the tax. No Petition for Rehearing was filed by Geoffrey.

On October 1, 1993, Geoffrey filed with the United States Supreme Court a Petition for a Writ of Certiorari. The Petition was received by the Department of Revenue by mail on October 8, 1993.

2. Factual Background

The taxpayer, Geoffrey, is a Delaware Corporation created in 1984 as a second-tier subsidiary of Toys "R" Us. (Tr. p. 14) Geoffrey became the owner of several very valuable trademarks and symbols, such as Toys "R" Us, Kids "R" Us and Geoffrey, the giraffe. In order to produce income from these symbols and trademarks, Geoffrey entered into a licensing agreement in August of 1984 with Toys "R" Us. Toys was allowed to use the trademarks and symbols and receive Geoffrey's "merchandising skills, techniques and know-how in the operation of [Toys] business." (Tr. p. 118) In return, Toys paid Geoffrey a 1% royalty or license fee based on the sales made by Toys. (Tr. p. 119) The right to use the trademarks, symbols and know-how was licensed for use in South Carolina, as well as all other states with the exceptions of Massachusetts, Pennsylvania, New Jersey, Texas and New York.

The symbols themselves are prominently displayed in South Carolina on the licensee's buildings and are used on the tags of the merchandise sold in the State, as well as on the advertising material distributed in the State. (Tr. pp. 77-78) In fact, the visibility of the symbols is an important factor in allowing Geoffrey to generate royalties. The parties from whom Geoffrey receives its royalties are in a seasonal business and produce fifty percent (50%) of Geoffrey's royalty income in the eight weeks before Christmas. (Tr. p. 17) Thus, high visibility of the symbols and trademarks is important to allow Geoffrey to derive its income.

Geoffrey is quite concerned that its trademarks may be diminished in value and has taken steps to protect its property. In order to protect its value, the license agreement allows Geoffrey significant control over the use of the symbol by the

licensee. Geoffrey is able to tell its licensee that it does not want the licensee to sell specified merchandise in South Carolina. (Tr. pp. 33-34, 79) Additionally, it can tell the licensee that it does not want a particular advertisement used in South Carolina. (Tr. pp. 33-34, 79) In the event of an infringement on the trademarks or symols, Geoffrey has the right to bring suit in South Carolina to protect its property. (Tr. pp. 31, 79)

Geoffrey also has an interest in collecting the amounts due it under the license agreement. Geoffrey has the right to inspect the books relating to royalties derived from sales in South Carolina to ensure that proper payment is being made. (Tr. pp. 32, 79) Geoffrey allows the accrual of royalty payments and may use the courts of this State to enforce any violation of the agreement relative to acts committed in South Carolina. (Tr. pp. 34-35)

Geoffrey does not file an income tax return with and does not pay any income tax to any state on its royalty income. (Tr. p. 40) It is exempt from Delaware income tax and files only a franchise tax report with Delaware.(Tr. p. 37) The royalty payment paid to Geoffrey by Toys is deducted by Toys in calculating Toys' South Carolina income (Tr. p. 40), while the income to Geoffrey from this transaction is not reported by Geoffrey to South Carolina.

The Department of Revenue concluded Geoffrey was subject to taxation in South Carolina. The Trial Court agreed, as did the South Carolina Supreme Court. The taxability of Geoffrey in South Carolina is the basic issue now before this Court.

ARGUMENT

I. THE GEOFFREY DECISION DOES NOTHING MORE THAN TAX A FRANCHISOR BASED UPON

THE FRANCHISOR'S BUSINESS ACTIVITY IN SOUTH CAROLINA.

A. Petitioner Mischaracterizes The Case.

"The sky is falling, the sky is falling!" cried Chicken Little to Henny Penny.[1] The sky did not fall in the tale of Chicken Little and neither has the Supreme Court of South Carolina shattered the heavens by the Geoffrey decision. In fact, the constant theme of dire consequences permeating the Petitioner's argument serves to confuse rather than illuminate.

This is not a case of extremes as the Petitioner would have the Court believe. For example, Petitioner asserts the Geoffrey decision taxes an electronic data bank because "its logo [is] flashed across the computer screen." (Pet. p. 9) Petitioner provides no analysis for such a conclusion. Instead of analysis, Petitioner is content to assert that"[u]nder the court's ruling, whenever a person's intangible property is used by others, the

---

[1] Classic English folktale. See the modern version, *Henny Penny* by Paul Goldone, the Seabury Press, New York (1968). The Petitioner appears to argue this Court should grant Certiorari on the grounds of sheer panic. Petitioner feeds this mentality by statements such as the Geoffrey decision "has staggering implications" (Pet. p. 9) that unless resolved "will create chaos in interstate tax administration." (Pet. p. 10) The Geoffrey decision will impose a "burden that . . . would be overwhelming" (Pet. p. 19) and further, the decision is "simply astounding." (Pet. p. 20) As if in fear that its previous statements of impending doom have gone unnoticed or unbelieved, Petitioner closes its argument with the assurance that "this parade of horribles [is not] imaginary." (Pet. p. 20) After a careful review of the Petitioner's display of paralyzing anxiety inflicted by a single decision of a South Carolina court, one cannot help but become suspicious of the attack. Is the "parade of horribles" perhaps an attempt to draw the Court's attention away from the actual case decided below? One is left with an uneasy feeling since "[t]he [taxpayer] doth protest too much, me thinks." *Hamlet,* Act III, scene 2.

person will be subject to tax wherever such property is used." (Pet. p. 20) Instead of arguing the Geoffrey case, the Petitioner seeks to lure the Court into answering countless hypothetical arrangements unsupported by the factual scrutiny afforded by a trial court examination.[2] Petitioner, without the benefit or confines of factual determinations, concludes that authors, television producers, software developers, banks merely holding securities, and athletes making endorsements, are subject to unlimited taxation under the ruling of the Geoffrey decision. (Pet. p. 20) Further, Petitioner is so bold as to assert the Geoffrey decision not only taxes parties that are doing business in a state, but also parties that admittedly are not doing business in the state.[3]

Petitioner attempts to show the Geoffrey decision taxes all things at all times, whether doing business or not doing business. Petitioner's extremes should not be allowed to form the basis for this Court's decision to grant or deny Certiorari. If Certiorari is to be granted, let it be granted on the case that was argued below; if it is to be denied, let the denial address the facts developed.

B. Geoffrey Is Properly Taxed As A Franchisor.

The South Carolina Supreme Court decided the Geoffrey case, and only the Geoffrey case. The facts as established by the Trial Court, and as affirmed by the Supreme Court cannot be altered by speculation on the outcome of untried hypothetical

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[2]Facts are critical to correct legal conclusions. "If you get all the facts, your judgment can be right; if you don't get all the facts, it can't be right." Bernard Baruch.

[3]The Petitioner argues that under the Geoffrey decision a company receiving payments for a covenant not to compete " will be taxable in every state in which it has agreed NOT to do business...." (Pet. p. 20; emphasis in orignal)

arrangements. The facts of Geoffrey support the taxation of the income here in dispute.

1. The Facts Make Geoffrey An Active Franchisor.

The Trial Court found the agreement between Geoffrey and Toys was a franchise. (Pet. p. 22a) Further, the Supreme Court found there was no challenge, either factual or legal, to the Court's conclusion. (Pet. pp. 5a-6a) Thus, the law of the case is that Geoffrey operated as a franchisor by virtue of its agreement with Toys, the franchisee.

Under the franchise agreement, both Geoffrey and Toys used the symbols and trademarks in South Carolina to further their businesses. Both franchisor and franchisee benefited from the symbols since the income to each was based upon splitting a percentage of the sales. Geoffrey was in the business of receiving income resulting from the sales of licensed products with its symbols being the means for producing those sales. Geoffrey admitted it received no income or value from its symbols unless sales of licensed products or services were made. (Tr. p. 29) Thus, the sale of a licensed product or service was the ultimate aim of the franchise for both the franchisor and the franchisee.

Geoffrey contributed to the sale of products by its ability to regulate sales. For example, the franchisor retained the right to direct the franchisee not to sell specified merchandise in South Carolina, as well as the right to prohibit particular advertisement in South Carolina. (Tr. pp. 33-34, 79) Further, the record shows that Geoffrey generates fifty percent (50%) of its income in the eight weeks before Christmas. (Tr. p. 17) Given such a high volume of sales in such a short period, the franchisor has just basis for retaining the right to supervise products and advertisement. A defective product or

inappropriate advertisement may cause extensive loss of sales at a most critical period of income potential. Accordingly, Geoffrey's symbols are used in South Carolina by Geoffrey itself. Geoffrey's involvement in this State is substantial, ongoing and basic to its ability to produce income.

2. Franchisors Are Taxable On Their Franchise Income.

The taxation of a franchisor presents neither a "staggering" decision (Pet. p. 9) nor one that is "astounding." (Pet. p. 20) At least as early as 1979, franchisors have been held taxable on the basis the taxpayer has "[a] bundle of intangible rights being employed in [the state]." *Baskins-Robins Ice Cream Company v. Revenue Division,* 599 P.2d 1098, 1100 (N.M. App. 1979). Such a conclusion was reached even where the franchisor owned no property, had no employees, did not manufacture and did not sell any products in the State. Also see *American Dairy Queen Corp. v. Taxation and Revenue Dept.,* 605 P.2d 251 (N.M. App. 1979); *AAMCO Transmissions, Inc. v. Taxation and Revenue Dept.,* 600 P.2d 841 (N.M. App. 1979), cert. denied by 598 P.2d 1165 (N.M. 1979).

3. The Conducting Of An Ongoing Business In A State By Means Of An Integrated Intangible Establishes A Substantial Nexus With The State.

The Geoffrey decision is based upon well-established precedent. A state may constitutionally impose an income tax "upon incomes accruing to nonresidents from their property or business within the State . . . ." *Schaffer v. Carter,* 252 U.S. 37, 52, 40 S.Ct. 221, 225 (1920). Further, a taxpayer domiciled in one state but carrying on a business in a second state ". . . is subject to a tax there measured by the value of the intangibles used in his business" (cites omitted); *Curry v. McClanless,* 307 U.S. 357, 368, 59 S.Ct. 900, 906 (1939). Finally, a determination

that the business is conducted in the state also means that any intangible that is an integral part of the business acquires the same situs as the business location. See *Wheeling Steel Corp. v. Fox,* 298 U.S. 193, 56 S.Ct. 773 (1936), for the rule expressed in a property tax context. Thus, the presence of the "business" in the state establishes the presence in the state of any intangible that is an integral part of the business.

The South Carolina Supreme Court found "Geoffrey's business is the ownership, licensing, and management of trademarks, trade names, and franchises." (Pet. p. 5a) The Trial Court and the Supreme Court found factually that Geoffrey held a franchise in South Carolina. (Pet. p. 5a) Further, it is the franchise business that Geoffrey conducted in South Carolina. (Pet. pp. 5a-6a) In conducting its franchise business, Geoffrey was simply taxed as any other entity conducting a business in the State. See *Schaffer v. Carter,* supra. Such a business was integrally related to the intangible franchise, and accordingly the franchise was also present in the state. See *Wheeling Steel Corp. v. Fox,* supra. The presence of the property in the state and the carrying on of the business in the state are well within existing precedent and presents nothing warranting review by the United States Supreme Court.

The use of the franchise in South Carolina satisfies the Commerce Clause nexus requirement. Substantial nexus must exist between the taxing state and the activity being taxed. *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274, 279, 97 S.Ct. 1076, 1079 (1977). Such nexus may be satisfied even where there are no employees and no office in the state. In *Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue,* 483 U.S. 232, 107 S.Ct. 2810 (1987), the Court upheld the imposition of a wholesale business and occupation tax on an out-of-state corporation whose only contact with the state was

the presence of independent contractors in the state. The only function of the independent contractors was the solicitation of sales on behalf of the taxpayer. In finding no nexus violation, the Court stated the following:

> . . . the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.

Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue, supra., 107 S.Ct. 2810 at 2821.

Substantial nexus exists between the Petitioner and the activities in South Carolina. The Petitioner's business, as determined by the Supreme Court, is that of "ownership, licensing, and management of trademarks, trade names, and franchises." (Pet. p. 5a) The Supreme Court held the intangible, the franchise, was itself used in South Carolina. (Pet. p. 10a) Sales occurred in South Carolina from which Petitioner received a percentage of the sale (Tr. p. 119) with the record establishing that no value was derived by the intangibles unless sales were made. (Tr. p. 29) Petitioner's franchise, exercised through the sales by Toys, enabled Petitioner "to establish and maintain a market in [South Carolina]." *Tyler Pipe, Id.* Petitioner has substantial nexus in South Carolina.

II. THE GEOFFREY CASE IS NOT SUITABLE FOR DETERMINING WHETHER THE "BRIGHT-LINE PHYSICAL-PRESENCE" STANDARD OF *QUILL* APPLIES TO AN INCOME TAX SINCE GEOFFREY'S BUSINESS DEALS SOLELY WITH INTANGIBLES AND SINCE *QUILL,* IN ANY

EVENT, DOES NOT LEAVE OPEN SUCH A QUESTION.

The Petitioner believes the Geoffrey case should be reviewed since it is a suitable vehicle for determining whether the "bright-line physical-presence" standard applied to a use tax collection matter by *Quill Corp. v. North Dakota,* 112 S.Ct. 1904 (1992), should also be applied to an income tax. (Pet. pp. 10-14) Petitioner's belief is incorrect for two fundamental reasons. First, Geoffrey presents the least likely case for addressing a physical-presence standard since the sole business of Geoffrey is that of dealing in intangibles. Second, *Quill,* supra, did not leave an unanswered question as to income taxation, but rather reaffirmed an existing rule as to use tax.

A. Geoffrey Is Not Suitable For Examining The Physical-Presence Standard.

Applying the physical-presence standard to a taxpayer like Geoffrey makes the standard meaningless. The Commerce Clause is intended to require the foreign taxpayer to pay its fair share of government. *Quill,* supra, 112 S.Ct. at p. 1912, n. 5. If a physical presence is the means for establishing when a taxpayer is liable for payment of its fair share of government, then those taxpayers dealing solely in intangibles, like Geoffrey, will have no physical presence and, thus, no tax responsibility in numerous states from which substantial income is derived. Such would be true, notwithstanding the fact that South Carolina provides a market for the franchise (Pet. p. 21a) and provides "the protection, benefits, and opportunities" afforded its franchise activity. (Pet. p. 9a) If physical presence is a potential standard for judging the taxability of income, surely that standard needs to be developed in the context of a taxpayer whose business supports a physical presence approach rather than a taxpayer whose sole business is that of dealing in intangibles.

Geoffrey's business encompasses intangibles: symbols, franchises, licensing agreements and trademarks. Under Petitioner's view, Geoffrey's physical location is where its directors meet and its books are kept. Thus, there is no presence in the very states in which the sales occur that produce its royalties. It receives the benefits of government without having to pay the fair share of the costs of government. Such a result is incompatible with the purpose of the Commerce Clause, and accordingly, Geoffrey is not a suitable vehicle for articulating a physical-presence standard for income taxation.

B. Quill Does Not Leave An Unanswered Question.

Petitioner states the Court in *Quill* left open the question of "... whether a state may impose an income tax on a taxpayer with no physical presence in the state." (Pet. p. 9) A careful reading of *Quill* shows the Court did not leave open such a question.

The Court in *Quill* addressed a specific issue concerning the Commerce Clause requirements of a seller to collect a use tax where the seller's only connection with customers in the state was by common carrier or the United States Mail. The Court, in the language used in reaching its decision, reaffirmed the rule for use tax, but did not impose such a rule on an income tax.

> ... although our Commerce Clause jurisprudence now favors a more flexible balancing analyses, we have never intimated a desire to reject all established "bright-line" tests. Although we have not in our review of other types of taxes, articulated the same physical-presence requirement that Bellas Hess established for sales and use taxes, that silence does not imply repudiation of the Bellas Hess rule.

Quill, 112 S.Ct. at p. 1914.

> In sum, although in our cases subsequent to Bellas Hess and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that Bellas Hess established in the area of sale and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine of stare decisis indicate that the Bellas Hess rule remains good law.

Quill, 112 S.Ct. at p. 1916.

The language demonstrates the physical-presence test "in other types of taxes" was not imposed. The Court, however, felt that such a test was required in the context of the collection of a use tax. The use of a physical-presence test in the use tax area was approved due to the need for complying with the settled expectations of businesses that have relied upon *National Bellas Hess, Inc. v. Department of Revenue,* 386 U.S. 753 (1967) since 1967.

> Moreover, a bright-line rule on the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals.

Quill, supra, 112 S.Ct. at p. 1915.

The physical-presence rule was relied upon by the mail-order industry and there was no basis under the rules of *stare decisis* upon which to reverse these settled expectations.

> . . . the continuing value of a bright-line rule in this area [of use taxes] and the doctrine and principles of

> stare decisis indicate that the Bellas Hess rule remains good law.

Quill, supra, 112 S.Ct. at p. 1916.

In the income tax area, as opposed to the use tax area, there are likewise settled expectations. In the income tax area, the expectation is that no physical presence is required, but rather, only the presence of a business activity in the taxing state is required. As early as 1875, the Court held that "... profits of all corporations are liable to taxation in the place where they do business." *State Railroad Tax Cases, 92 U.S. 575, 603 (1875); Schaffer v. Carter,* supra, ("... a state may ... levy a duty ... upon incomes accruing to non-residents from their property or business within the State, or their occupations carried on therein."). Further, the Court has held that income that has no independent physical location in the taxing state may still be taxed by that state so long as the income is part of the unitary income of the business which is conducted in the taxing state. *Mobil Oil Corp. v. Commissioner of Taxes,* 445 U.S. 425, 100 S.Ct. 1223 (1980).

Thus, the judicial history is that a taxpayer is liable for an income tax if the business activities are either directly or indirectly conducted in the taxing state without regard to whether the taxpayer has a physical presence in the state. *Quill,* supra, makes no attempt to change that position by imposing a physical-presence standard. To do so would upset the same reliance interests and *stare decisis* interests that were important in *Quill.* If those interests are strong enough to retain the physical-presence standard in the use tax area, those same interests are strong enough to retain the "business activity" standard in the income tax area. Thus, *Quill* leaves no unanswered question of physical presence as a standard in an income tax area, but rather only reconfirms the standard

applicable to a use tax collection matter. Accordingly, Certiorari should not be granted here.

III. THE STATE COURT'S ANALYSIS OF THE DUE PROCESS CLAUSE FOLLOWED ESTABLISHED PRECEDENT AS TO THE REQUIREMENT OF THE TAXPAYER'S CONNECTION WITH THE STATE.

The Due Process Clause places two restrictions on a state's power to tax the income generated by the activities of an interstate business. "First, no tax may be imposed unless there is some minimal connection between those activities and the taxing state . . . [and] [s]econd the income attributed to the State for tax purposes must be rationally related to 'values connected with the taxing State'." *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 273 (1978) (citations omitted). The South Carolina Supreme Court addressed both of these restrictions in its Opinion. Geoffrey has only challenged the first requirement of minimal connection in its Petition for Writ of Certiorari.

In 1992, this Court addressed the requirement of minimal connection in *Quill Corp. v. North Dakota*, supra. The Court held the Due Process Clause did not require a corporation to have physical presence in a state in order for the state to require the corporation to collect a use tax. *Id.* at 1911. In reaching this conclusion, the Court utilized the due process analysis which has been developed concerning personal jurisdiction over a nonresident.

With respect to personal jurisdiction, this Court has held a forum state did not violate the Due Process Clause by asserting personal jurisdiction over a corporation that delivered its products into the stream of commerce with the expectation the products would be purchased by consumers in the forum

state. *World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286, 298 (1980). The Court has also held a foreign corporation may subject itself to in personam jurisdiction in a state without physical presence if it purposefully avails itself of the benefits of an economic market in the forum state. *Burger King Corp. v. Rudzewicz,* 471 U.S. 462, 476 (1985). Applying these concepts in *Quill,* the Court concluded the out-of-state mail-order house had purposefully directed its activities to North Dakota residents and, therefore, the Due Process Clause did not bar North Dakota's enforcement of its use tax against *Quill.*[4]

The South Carolina Supreme Court did not, as intimated, misapply the due process concepts postulated by this Court. Rather, it properly applied them to the particular facts of the case before it to determine Geoffrey's connection to South Carolina. Geoffrey's corporate income comes from the royalties paid to it for the use of its trademarks and symbols. Geoffrey has a licensing agreement with Toys "R" Us. (Tr. pp. 116-133) The licensing agreement between Geoffrey and Toys "R" Us computes the royalties paid to Geoffrey based upon a percentage of the net sales by Toys "R" Us of the "Licensed Products sold or Licensed Services rendered under the Licensed Mark." (Tr. p. 119) Therefore, for every toy sold in South Carolina which uses the Geoffrey trademark, Geoffrey receives a portion of that net sales price as a royalty. This licensing agreement allows the use of the licensed marks and symbols in all states except Massachusetts, Pennsylvania, New Jersey, Texas and New York. (Tr. pp. 119, 133) Geoffrey was therefore, aware its trademarks could be used in South Carolina. Geoffrey can also exercise control over the use of its

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[4]The Court's analysis of the Commerce Clause in *Quill* reached a different conclusion with respect to physical presence for use tax purposes.

marks and symbols to maximize its profits. It has the authority to approve what merchandise and services can be sold with its trademark. (Tr. p. 121) It has the authority to approve the advertising and sales promotion materials to be used with its trademark. (Tr. p. 122) It can inspect the books and records of the licensee, Toys "R" Us, to determine the royalties due to it. (Tr. p. 120)

Therefore, contrary to the assertions in the Petition, Geoffrey is not a mere passive actor dragged unwillingly into the economic market of South Carolina. Rather, as found by the South Carolina Supreme Court, Geoffrey has purposefully directed activity toward South Carolina's economic market by consciously allowing and controlling the use of its trademarks in the State and thereby generating royalty income to it from sales in South Carolina.

There is also no violation of the notions of "fair play and substantial justice" by taxing Geoffrey in South Carolina. The State seeks to tax only that portion of Geoffrey's income which is generated within South Carolina. The Petitioner has not challenged this apportionment. Further, when the fog of Petitioner's "licensor of intangibles" argument is pierced, the conclusion is clear that Geoffrey reaps the benefits of South Carolina's orderly society when it earns income from the sales by Toys "R" Us to South Carolina residents. To claim otherwise is simply to ignore fact for fiction.

CONCLUSION

Geoffrey presents a case in which the owner of a franchise intentionally and purposefully directs its activity to South Carolina. The resulting income of Geoffrey is from the splitting of the sales price of products and services sold and consumed in South Carolina. Geoffrey's substantial and

continuous activities create the necessary nexus for Commerce Clause and Due Process Clause purposes. Accordingly, the Petition for Writ of Certiorari should be denied.

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November 1, 1993

Supreme Court, U.S.
FILED
OCT 29 1993

No. 93-520

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,

v.

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REVENUE AND TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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BRIEF OF THE COMMITTEE ON STATE TAXATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

INTRODUCTORY STATEMENT

This brief is submitted by the Committee on State Taxation as *amicus curiae* in support of the petitioner in the above-captioned matter. Written consents of the petitioner and respondent have been obtained and filed with the Clerk of the Court.

INTEREST OF *AMICUS CURIAE*

The Committee on State Taxation ("COST") is a non-profit association that was organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. COST, which was separately incorporated on January 1, 1992, has a membership of more than 400 major multistate corporations, engaged in interstate and international business. COST's objective is to preserve

and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities.

Many of COST's member companies are engaged in business in the State of South Carolina, as well as in other states now asserting the *Geoffrey* theory of economic presence as nexus for purposes of income tax jurisdiction. The impact of the *Geoffrey* decision and the reach of state nexus statutes based on economic presence is much broader than immediately apparent. Most taxpayers are sensitive to and careful in following established nexus rules and Public Law 86-272. Where radical departures from accepted notions of nexus are permitted to occur on an *ad hoc* basis, as in this case, taxpayers that previously understood their compliance responsibilities are left without guidance, and their ability to comply with state tax laws is severely impaired. Therefore, COST has an interest in the instant case.

SUMMARY OF ARGUMENT

This Court has set a bright-line test of physical presence as a predicate for states exercising their taxing jurisdiction. *Quill Corporation v. North Dakota*, 112 S. Ct. 1904 (1992). States can adopt and utilize a variety of statutory tools to enforce their jurisdiction against any entity whose physical presence has been established. Absent this requisite connection to the taxing jurisdiction, the state may not employ any of those tools to impose a tax liability against an entity. Further, the states are not free to ignore the available statutory tools nor may they choose not to use them for the perceived expediency of taxing non-nexus entities; the very expediency that is attractive to South Carolina is based upon a violation of the Constitution.

The Commerce Clause places a premium on the maintenance of a degree of certainty in commerce. It requires that states (1) adhere to the constitutional principles under which they exercise their sovereign rights to tax, and (2) utilize only taxing methods and tools that have

been legislatively or judicially crafted. It does not permit the interstate chaos generated by the selection of tax targets without physical presence in the taxing state.

ARGUMENT

I. STATUTORY TOOLS ARE AVAILABLE TO THE STATE TO ENFORCE ITS TAXING JURISDICTION WITHIN THE "BRIGHT LINES" DRAWN BY *QUILL*, THEREFORE UNPRINCIPLED EXTENSIONS OF THAT JURISDICTION SHOULD NOT BE TOLERATED.

In *Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1916 (1992), this Court established a "bright-line" nexus test, based upon physical presence. This standard is consistent with the Court's other nexus holdings and is not inconsistent with the technologically advanced state of commerce. The bright-line physical presence requirement also satisfies the specific concerns underlying the Commerce Clause (establishing boundaries of legitimate state authority, reducing litigation, and encouraging settled taxpayer expectations). *See Quill*, 122 S. Ct. at 1915-16. None of this Court's nexus jurisprudence, including the recent *Quill* case (a use tax nexus case) and previous income tax nexus cases, provides support for the South Carolina Supreme Court's radical conclusion that the "minimum contacts" and "substantial nexus" required in order to be subject to a state's income tax can be established without some physical presence in that state. Nexus based upon mere economic presence does not exist, nor is the creation of such a standard justified.

South Carolina, like every other State, has a number of statutory and judicially crafted tools for the purpose of enforcing its constitutional taxing jurisdiction and applying specific tax provisions to a taxpayer that is subject to its jurisdiction. Among these tools are: (i) the arbitrary shifting of income doctrine, whereby the State readjusts intercompany transaction prices, so as to address

non-fair market value charges for goods and services, and other practices by which the net income of one corporation has been arbitrarily shifted to one or more other corporations in a group under substantially common control; (ii) the step transaction doctrine, whereby the State collapses several sequential transactions between two or more substantive entities that are designed to either avoid or reassign to another party the tax consequences that the collapsed single-step transaction would have engendered; and (iii) the sham transaction doctrine, whereby the income of a non-taxpayer corporation that the State demonstrates to be a "paper corporation" is flowed through to the substantive South Carolina taxpayer whose activities in reality generated that income.

Aside from the existing statutory tools that the State resolutely ignores, South Carolina could at any time—without crossing *Quill*'s bright line and asserting jurisdiction over an entity lacking physical presence in the State—legislatively adopt other powerful tools that would legitimately enable it to tax the transaction between Toys R Us and its affiliate Geoffrey. The South Carolina legislature could adopt the domestic combination method of reporting. Under this method, Toys R Us—the unitary affiliate with South Carolina nexus—would be required to file a combined return in the state; while the mechanics of the formula are somewhat complex, the effect would be to include in the apportionable tax base of Toys R Us all income realized by its unitary affiliate Geoffrey on its trademark licensing activities.[1] This method of taxing

[1] The combined apportionment formula would include in the denominators of its apportionment fractions the payroll, property and sales of Geoffrey. The effective increase in tax liability of Toys R Us that results when Toys R Us is required to file a combined return is generated by the elimination of all intercompany transactions from the return; to the extent that Geoffrey's licensing royalties are attributed to members of the combined group, they are eliminated, but so too is the deduction Toys R Us had received on a separate return with respect to license fee payments made to Geoffrey.

Toys R Us would satisfy the constitutional principles that are violated by South Carolina's assertion of economic presence jurisdiction over Geoffrey.

For a variety of political reasons, states choose differing methods of taxation and enforcement tools; but in every case, the implementation of a chosen method or tool must be even-handed, *i.e.*, the State must apply and enforce the method without regard to whether it results in a tax reduction or increase to specific taxpayers. It may be that the tools that a State has adopted do not reach a specific form of income or a specific taxpayer, or are not easy to employ in a given situation; nevertheless, the State cannot create or implement an *ad hoc* theory that abandons established principles of nexus. Such abandonment introduces a high degree of uncertainty in an area where the taxpayer is expected, at least initially, to make an accurate determination of its tax liability.

II. *GEOFFERY* INTERJECTS UNCERTAINTY FOR TAXPAYERS THAT DO NOT DO BUSINESS OR HAVE PHYSICAL PRESENCE IN A GIVEN STATE.

The stakes in *Geoffrey* are much more significant than the limited facts of the case indicate. Other states have actually moved to assert income tax jurisdiction over corporations with no physical presence in their states. A survey of COST's member corporations has yielded many potential applications and extensions of the *Geoffrey* nexus doctrine which will impact almost every segment of American industry and business. The several examples below, like those presented by Geoffrey, *see Petition* pp. 9 and 20, illustrate the uncertainty that results where states reject their legislated tools (many of which adequately address the factual scenarios presented) in favor of a *Geoffrey* economic presence approach:

(1) Public Law 86-272: A very basic and unsettling question raised by the decision below is whether a brand

name product manufacturer may in every instance be subject to income taxation by a *Geoffrey* state, even where it is otherwise clearly protected by Public Law 86-272.[2] A state could in the name of *Geoffrey* assert that an intangible property interest of the manufacturer—goodwill—is created in that state in every instance where the manufacturer's brand name products compete against generic products. A favorable selling price differential for a branded product may generate income to the manufacturer. Because the brand name was intentionally placed in the state market, the question arises whether the manufacturer could be taxed on the portion of its income attributable to goodwill, this despite the fact that Congress has explicitly stated that persons complying with the limitations on their in-state activities set forth in Public Law 86-272 would be protected from income taxation by a state. The next question is whether, once *Geoffrey* economic presence nexus is established, a state will go one step further and assert the right to tax *all* income of such a company, contrary to the dictates of Public Law 86-272, on the grounds either that *Geoffrey* economic presence nexus is an independent basis for asserting its tax jurisdiction, or that the company is engaged in more than mere solicitation in the state, by way of its "economic presence" there.

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[2] 73 Stat. 555, 15 U.S.C. sec. 381. Public Law 86-272 protects any person engaged in interstate commerce from income taxation by a State if the person's only activities in that State are either or both of the following: "(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the state for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1)." *See, e.g., Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992).

(2) Patent royalties: Where a patent holder doing business only in State X licenses a manufacturer in State A, the licensee manufacturer in State A could receive income from the sale lease of patented articles in State A, which are removed by the purchaser to State B. That transaction generates royalty income to the licensor. Under *Geoffrey*, it would appear that this generation of income creates nexus to tax the licensor in State A. However, if none of the patented articles are sold in State A, is the licensor nonetheless taxable in State A? Questions persist regarding the implementation of this doctrine: Is the patent licensor likewise liable for income tax in State B (and every other state to which patented articles are removed)? If the patented articles are also sold in State B, is the licensor liable for income tax in that state?

(3) Broadcast nexus: Several states have indicated their potential interest in assessing income tax against every NFL and other professional sports team whose games are televised within a state, even if no games are ever played within the taxing state by such teams. In such a case, the licensee's broadcast of the game in any state apparently will be deemed to trigger jurisdiction over the licensor based upon the intangible right that generates income to the team. However, does a *Geoffrey* analysis apply if the broadcast license fee is predetermined and does not depend on any state's viewership figures, or upon revenue raised by the broadcaster from advertisers in that state?

If the *Geoffrey* economic presence theory is left intact, taxpayers will be unable to determine whether they have nexus with a particular state for tax purposes. Even if the legislated tools adopted by a state do not apply to a taxpayer under the bright-line test of *Quill*, the States will feel free to ignore this Court's nexus jurisprudence in a manner designed to avoid the legislative process and to reach taxpayers or income on an unprincipled, case-by-case basis.

CONCLUSION

For the reasons set forth above, the Committee on State Taxation respectfully requests that petitioner's petition for writ of certiorari be granted.

Respectfully submitted,

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Dated: October 29, 1993.

FILED
OCT 29 1993
OFFICE OF THE CLERK

No. 93-520

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BRIEF FOR THE INTERNATIONAL FRANCHISE ASSOCIATION, AS AMICUS CURIAE SUPPORTING PETITIONER

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BRIEF FOR THE INTERNATIONAL FRANCHISE ASSOCIATION, AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE AMICUS CURIAE

The International Franchise Association ("IFA") is a trade association of more than 600 franchising company members, representing over 60 industries, in many of which franchising is the predominant method of distribution of goods and services. IFA members are franchisors of a large majority of the franchised service businesses in the United States. Franchise networks of products and services currently account for more than $800 billion of

annual sales (about one-third of total retail sales) and more than 500,000 businesses. Franchisors and their franchisees employ eight million people. The largest franchisors have more than 5,000 outlets, the smallest under 10. The great majority of the approximately 2,500 franchisors operating in the United States are small companies, with fewer than 50 franchised outlets.

Franchising is a highly successful business relationship. Central to the relationship between a franchisor and its franchisees is a shared trade identity. This shared trade identity is established and maintained by the franchisor's license of its trademark, trade dress and other intellectual property (*i.e.*, intangible property) to each of its franchisees. Thus, each of the hundreds of thousands of franchise relationships that exist in the United States involves a license of intangible property. The great majority of those licenses cross state lines.

Most franchisors own no property in the states in which their franchisees operate, do not maintain offices there and employ no residents of those states. A franchisor's employees may make occasional visits to its franchisee's place of business to assist the franchisee in opening his business and to inspect the franchisee's performance and furnish advice and guidance, but the duration of such visits normally is a few hours. The services that a franchisor furnishes to its franchisees, and communication among a franchisor and its franchisees, are implemented almost entirely at the franchisor's principal offices and through interstate communications media. Most franchisors do not rely on the states of their franchisees' domicile for any services and impose no costs on these states.

The franchise relationship has evolved over the last half century on the basis that the franchisor is not subject to

state income taxes (other than those imposed by the franchisor's domicile) on the royalty income paid to the franchisor by franchisees located in a different state. Prior to the late 1980's, with rare exception, the states have not sought to tax such income, unless the franchisor clearly established a traditional nexus by owning or leasing real estate, operating its own outlets, or maintaining an office or employees in the taxing state. The pricing of franchises has developed on the basis that the franchisor's net income will be taxed only by its state of domicile. If every state where a franchisor has granted franchises may tax its income attributable to that state, the franchisor will be subject to costly compliance burdens and overlapping taxes that were not anticipated by the franchisor when it entered into long-term agreements (typically 10 to 20 years), which cannot be adjusted to reflect the higher costs and burdens it will incur.

In the past several years, a number of states have asserted that out-of-state franchisors are subject to the state's tax on income earned by the franchisor from franchisees operating within the state. The decision of the South Carolina Supreme Court,[1] and the disposition of the instant Petition for a Writ of Certiorari, is being widely and carefully watched by many states and the Multistate Tax Commission. *See* Petition for a Writ of Certiorari, Appendix D. The states will read a denial of that Petition as a green light to greatly expand their right to tax out-of-state licensors of intangible property used within their borders, entirely without regard to the presence of

[1] The South Carolina Supreme Court's opinion in this case is printed as Appendix A to the Petition for a Writ of Certiorari filed with the Court in this case. References to the lower court's opinion are designated "App. A" followed by a page reference.

any other contact between the licensor and the state or whether the taxing state furnishes any benefits or services to such licensor. The magnitude of the resulting financial impact on thousands of American businesses would be immense.

Pursuant to Rule 37.2 of the Rules of this Court, IFA respectfully submits this brief as *amicus curiae* in support of Petitioner. Because IFA's members are licensors of intangible property, IFA has a substantial interest in the outcome of this case and is able to provide an additional and broader perspective on the issues presented. IFA believes this brief will assist the Court in analyzing and resolving these issues. The parties have consented to the filing of this brief, and their written consents have been filed with the Clerk of Court.

SUMMARY OF ARGUMENT

In the decision below, the South Carolina Supreme Court diminished to the vanishing point the limitations imposed by the Due Process Clause (U.S. CONST. amend. XIV, §1) and the Commerce Clause (U.S. CONST. art. I, §8, cl. 3) on the authority of states to impose income taxes on persons engaged in interstate commerce. This decision radically expands the classes of persons, relationships and transactions subject to state income taxation. The opinion has enormous implications for the many thousands of businesses engaged in interstate franchising and licensing of intangible property, a rapidly expanding part of the American economy. It will subject licensors of intangible property in interstate commerce to income taxation by every state in which goods or services exploiting the licensed intangible property are sold. This result is a radical departure from the current understanding of the reach of state

taxing authority. If allowed to stand, the decision will significantly increase the tax liabilities and burdens of compliance of thousands of American businesses to an extent that could not have been foreseen. Unless reviewed by this Court, the continuing uncertainty with respect to these issues will impose high costs on companies forced to operate in an environment in which their state tax liabilities are unclear.

The South Carolina Supreme Court has held that the mere presence of intangible property satisfies the "minimum connection" requirement under the Due Process Clause and the "substantial nexus" requirement under the Commerce Clause for the imposition of state income tax. In reaching this conclusion, the court relied as its sole authority on two lower-court New Mexico opinions from 1979 that have not since been followed by any other court. The court also assumed, without supporting rationale, that intangible property used by a licensee in a state constitutes property of the licensor having a legal situs in that state, thus establishing the requisite nexus for the state to tax the licensor. This far-reaching expansion of current state authority to tax interstate commerce should not become accepted law without review by this Court.

The South Carolina Supreme Court also articulated an essentially meaningless test for the Due Process Clause requirement that taxes imposed must be related to "values connected with the taxing State" (*Quill Corp. v. North Dakota ex rel. Heitkamp*, 112 S.Ct. 1904, 1909-10 (1992) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978))), and the Commerce Clause requirement that taxes must be "fairly related to the services provided by the State" (*Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)), by holding that the requirements are met with respect to a licensor if the state furnishes values and

benefits to its licensee operating within the state. Every state tax will pass this test, for every licensee of intangible property will derive some benefits and services from the state in which it operates. The effect of the South Carolina Supreme Court's interpretation is to write out of the Due Process and Commerce Clauses any meaningful limitations on the authority of states to impose taxes on out-of-state businesses that derive no values or services from the taxing state, significantly altering the current understanding of the parameters of state taxing authority. The rationale articulated by the South Carolina court is also fundamentally unfair, because it permits a state to tax an out-of-state business that imposes no costs on the state and derives no benefits or services from the state. The South Carolina Supreme Court's decision should not be allowed to stand without scrutiny by this Court.

IFA supports the Petitioner's argument that this Court should decide whether the physical-presence standard reaffirmed by this Court in *Quill* applies to state corporate income taxes. *See* Petition for a Writ of Certiorari Argument I at 10-14.

The decision below introduces rationales that greatly expand the constitutional power of states to tax interstate commerce and raise issues of great importance under both the Due Process and Commerce Clauses. The issues have enormous significance for a large and growing segment of American business. These are compelling reasons for this Court's review.

ARGUMENT

I. THIS COURT SHOULD DECIDE WHETHER A LICENSE OF INTANGIBLE PROPERTY THAT IS USED IN A STATE SATISFIES THE NEXUS REQUIREMENTS OF THE DUE PROCESS CLAUSE AND THE COMMERCE CLAUSE

In holding that the mere presence of intangible property in a state establishes the requisite constitutional nexus for the state to tax the owner of such property, the South Carolina Supreme Court greatly extended the reach of state taxing authority beyond its currently-accepted limits. Even if such an extension could be justified, the decision failed to establish a South Carolina situs for the intangible property of Geoffrey, Inc. ("Geoffrey").

A. The Lower Court's Conclusion Would Vastly Expand the Rights of States to Tax Companies that Have No Contact with the Taxing State

The South Carolina Supreme Court concluded that the "minimum connection" required by the Due Process Clause as well as the "substantial nexus" required by the Commerce Clause is established by the mere presence of intangible property in the state. App. A at 5a and 9a.[2] The

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[2] In analyzing the authority of South Carolina to tax Geoffrey under the Due Process Clause of the 14th Amendment of the U.S. Constitution, the South Carolina Supreme Court quoted *Quill*, that the standard for taxation under the Due Process Clause requires (i) "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax", and (ii) that the "income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." App. A at 4a, quoting *Quill*, 112 S.Ct. at 1909-10. The court also analyzed the application of the South Carolina income tax to Geoffrey under the Commerce Clause, interpreting the law as

(Footnote continued on following page)

court, however, did not provide any reasoning to support this conclusion.[3] The court thus has significantly expanded the authority of states to tax thousands of businesses in a broad range of interstate relationships and transactions. By its terms, the decision authorizes South Carolina to tax the income of an athlete with no connection to South Carolina, who has licensed a sporting goods company to manufacture and sell equipment bearing the athlete's name, solely on the basis that the equipment is sold through retail outlets located in South Carolina. Similarly, the decision permits South Carolina taxation of an out-of-state playwright whose copyrighted work is performed in South Carolina. Licensors of intangible property now

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[2] *continued*

follows: a tax will not violate the Commerce Clause provided the tax "(i) is applied to an activity with a substantial nexus with the taxing state, (ii) is fairly apportioned, (iii) does not discriminate against interstate commerce, and (iv) is fairly related to the services provided by the state." App. A at 9a (citing *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)).

[3] The court did refer to three cases: *American Dairy Queen Corp. v. Taxation & Revenue Dep't*, 605 P.2d 251 (N.M. Ct. App. 1979); *AAMCO Transmissions, Inc. v. Taxation & Revenue Dep't*, 600 P.2d 841 (N.M. Ct. App. 1979), *cert. denied*, 598 P.2d 1165 (N.M. 1979); and *International Harvester Co. v. Wisconsin Dep't of Tax.*, 322 U.S. 435 (1944). Both the *American Dairy Queen* and *AAMCO Transmissions* cases were decisions of lower courts in New Mexico. The opinion in *American Dairy Queen* offers virtually no legal reasoning in support of the permissibility of the tax at issue under the Due Process Clause or the Commerce Clause. The taxpayer in *AAMCO Transmissions* sold and leased tangible property to New Mexico residents, as well as licensed intangible property. The relevant facts in *International Harvester* were very different from those of this case, and did not involve an essentially interstate tax. In the fourteen years since the lower court decisions in New Mexico, no other court has upheld the constitutionality of a state tax based solely on the presence of intangible property in the state.

must bear state tax burdens which they have not historically borne, at great financial expense. If a tax return is not filed, no statute of limitations will limit the period for which taxes, interest and penalties may be due. The alternative, capitulating to the anticipated avalanche of state taxes on income generated by licensors of intangible property, is equally unpalatable and will severely distort the economic relationships of licensors and licensees of intangible property. Because of the far-reaching impact of the South Carolina Supreme Court's ruling, it is critical that the Court grant review of that decision.

B. The South Carolina Supreme Court Did Not Justify a South Carolina Situs for the Intangible Property of Geoffrey

Even if the presence of some intangible property in South Carolina is relevant to the authority of South Carolina to impose its income tax on Geoffrey, the South Carolina Supreme Court wrongly assumed—without supporting rationale—that Geoffrey's intangible property (*i.e.*, an account receivable and a franchise) had a situs in South Carolina. App. A at 5a. As demonstrated below, this assumption is not supported by established law.

The South Carolina Supreme Court found that because the royalties payable by Toys "R" Us, Inc. ("Toys R Us") to Geoffrey under their license agreement were paid once a year, the royalties accrued during the year and created an account receivable for Geoffrey. Granted, the debtor, Toys R Us, does business in South Carolina and the royalty is computed in part by reference to sales of Toys R Us in South Carolina. This does not, however, create intangible property with a South Carolina situs. Indeed, cases cited in the court's opinion for other purposes specifically held that the creditor's domicile or place of business

determines the situs of its accounts receivable. *See Virginia v. Imperial Coal Sales Co., Inc.*, 293 U.S. 15, 19 (1935) (holding that accounts receivable had their situs in the state in which the creditor was incorporated and had its principal office); and *Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 212-13 (1936) (attributing accounts receivable of a corporation to the state of its corporate headquarters). In the end, the South Carolina Supreme Court's analysis of Geoffrey's accounts receivable as justifying nexus to tax will subject creditors to income taxation by every state in which their debtors conduct business.

In an attempt to establish a nexus with South Carolina for Due Process and Commerce Clause purposes, the South Carolina Supreme Court independently determined that Geoffrey maintained a franchise in South Carolina. Although the court cited several cases rejecting the doctrine that a corporation's intangible property necessarily has as its situs the state of incorporation, the court did not provide any reasoning or persuasive legal authority for placing the situs of Geoffrey's franchise in South Carolina. The court cited to *Wheeling Steel*, but that case does not support South Carolina as the situs for Geoffrey's intangible property. In *Wheeling Steel*, the Court held that for state property tax purposes, the accounts receivable of a Delaware corporation had a situs in West Virginia, which was the location of the general business offices, books, records and management functions of the corporation. The Court stated:

> [I]t cannot properly be said that the credits arise either where the goods are manufactured or the sales offices where the orders are taken . . . . Here, the tax is a property tax on the accounts receivable, as separate items of property, and these are not to be regarded as parts of the manufacturing plants where the goods sold are produced.

298 U.S. at 212-13. Comparing Geoffrey's business to that reviewed in *Wheeling Steel*, Wheeling Steel's manufacturing plants and sales offices, although within the same corporation, are most closely analogous to the Toys R Us retail outlets. Just as the situs of Wheeling Steel's accounts receivable was the location of the corporation's management offices, where the contracts generating the accounts receivable are accepted and the payments are made, so the location of Geoffrey's corporate headquarters and management functions is the proper situs for its intangible property, not the location of the sales that are the source of revenues for payments under the license agreement.

The court below also cited another inapposite case, *Southern Express Co. v. Spigener*, 110 S.E. 403 (S.C. 1920), as holding that the situs of intangible property is within the state where the right afforded by it is exercised. App. A at 7a. *Southern Express* involved the taxation of a company that had contracted for the right to use certain intangible property and used that property in South Carolina. The plaintiff (taxpayer) in *Southern Express* was in effect a licensee of intangible property, similar to Toys R Us. The court in *Southern Express* held that the rights under the license were property of the licensee located in South Carolina. Thus, the holding of *Southern Express* supports taxing Toys R Us, but not Geoffrey, as a user of intangible property in South Carolina.

The IFA respectfully submits that the situs of the intangible property of a licensor of such property should be considered located in the jurisdiction where its management activities occur, where it receives payment for use of the property, where it negotiates or enters into contracts that generate revenue attributable to the property, or where it performs the activities that create and main-

tain the value of the property. Such activities include advertising, product development and testing, and maintaining a disciplined, competitive business system which enhances the value of the licensees' businesses. In most cases, these activities are performed by the licensor at its principal office, rather than in the locale of a licensee. In many cases, as with Geoffrey, the licensor has no contact with the state of the licensee.

In a typical franchise relationship, the activities a franchisor performs in the franchisee's state are limited to assistance in initially opening the franchisee's business and occasional visits to the franchisee's place of business. The duration of such visits is normally a few hours. The overwhelming majority of the franchisor's activities, as measured by time or value, are performed at the franchisor's principal office and through interstate communications media. To the extent that a franchise generates revenue for the franchisor, those revenues arise from the activities of the franchisor that create and maintain the value of the franchise. The geographic location in which those activities are performed should determine the jurisdiction to tax the revenues generated by them. The use of intangible property by a franchisee in its state of residence may support the right of that state to tax the franchisee, but it does not establish a situs for this property in the state of the franchisee for purposes of taxing the franchisor.

The importance of this issue to franchisors and to a broad range of other business relationships built around intangible property cannot be doubted. It is critical to those businesses that the Court address this issue.

II. THE SOUTH CAROLINA SUPREME COURT'S DECISION TO PERMIT STATE TAXATION OF COMPANIES THAT IMPOSE NO COSTS ON AND DERIVE NO BENEFITS FROM A TAXING STATE EMASCULATES THE DUE PROCESS AND COMMERCE CLAUSE REQUIREMENTS THAT A STATE TAX MUST BE RELATED TO SERVICES FURNISHED BY THE TAXING STATE

One of the two tests that a state tax must meet to avoid violating the Due Process Clause is that the "income attributed to the State for tax purposes must be rationally related to values connected with the taxing State." *Quill*, 112 S.Ct. at 1909-10. Similarly, to avoid violating the Commerce Clause, a state tax must be "fairly related to the services provided by the State". *Complete Auto Transit*, 430 U.S. at 279. The South Carolina Supreme Court held that both of these tests were satisfied by South Carolina "providing an orderly society in which Toys R Us conducts business, . . . [making] it possible for Geoffrey to earn income pursuant to the royalty agreement." App. A at 8a.

The court's interpretation of these elements of the Due Process Clause and Commerce Clause tests renders them meaningless. The requisite state-provided benefits are identified by the court as *various benefits provided to Toys R Us, not Geoffrey*. In other words, South Carolina has provided value and services to Geoffrey exclusively by providing value and services to Toys R Us, with whom Geoffrey has contracted, thereby allowing Toys R Us to generate revenues to meet its contractual obligations to Geoffrey. If services and benefits furnished to Toys R Us, the licensee of intangible property, can properly be considered services provided by South Carolina to Geoffrey, the licensor, South Carolina can assert that it furnishes services and benefits to every person receiving income that at any point in the chain of commerce passed through

the hands of a South Carolina resident, who benefits from the "orderly society" that South Carolina maintains. Although Geoffrey is only once removed from the party actually doing business in South Carolina, the same benefit would accrue to Geoffrey even if there were one or more unrelated, out-of-state intermediaries between Toys R Us and Geoffrey. The benefit of "providing an orderly society" is such a vague and amorphous service that it will exist in every case in which a taxing state's resident has earned income from business activity in the state (which is separately taxed by the state), out of which the resident makes a payment to an out-of state licensor. The South Carolina Supreme Court's rule thus emasculates the separate prongs of the Due Process Clause (requiring a rational relation to values connected with the taxing state) and the Commerce Clause (requiring a tax to be fairly related to the services provided by the state). *See Quill*, 112 S.Ct. at 1909-10, and *Complete Auto Transit*, 430 U.S. at 279.

Certainly more concrete, specific values and services can be identified within the concept of providing an orderly society, such as maintaining roads, sewers and police protection, but all of these more specific benefits can be clearly seen as applying only to Toys R Us, the licensee, and not to Geoffrey, the licensor. The only activities that a licensor may conduct in the state of its licensee are brief, periodic visits. Many licensors of intangible property have no contact whatsoever with the states where their intangible property is used. In most cases, the licensor does not maintain an office or other business location, own any property or employ any residents in the state of its licensee. Accordingly, the licensor derives no benefit from the services furnished by the state and local governments of the licensee's jurisdiction, and imposes no cost on these jurisdictions.

As applied by the South Carolina Supreme Court, the prongs of the Due Process Clause and the Commerce Clause relating taxation to values and services provided by the taxing state become tests that every state tax will meet in every instance. The effect is to write these separate, independently significant barriers to taxation completely out of the law. The South Carolina Supreme Court would permit state taxation of persons who impose no burdens on and derive no benefits from the taxing state. Such a change in the law would significantly expand the authority of states to tax the many thousands of businesses engaged in interstate transactions. Licensors of intangible property should not be subjected to taxation by states on which they impose no costs and from which they derive no benefits, without a determination by the Court that such taxation is consistent with "traditional notions of fair play and substantial justice."[4] For these reasons, it is incumbent on this Court to review the decision of the court below.

III. THIS COURT SHOULD DECIDE WHETHER THE PHYSICAL-PRESENCE TEST ARTICULATED IN *QUILL* APPLIES TO STATE CORPORATE INCOME TAXES

IFA adopts in its entirety the argument of Petitioner under the heading "I. THIS COURT SHOULD RESOLVE THE QUESTION WHETHER *QUILL'S* 'BRIGHT-LINE PHYSICAL-PRESENCE' STANDARD APPLIES TO STATE CORPORATE INCOME TAXES," found at pages 10-14 of the Petition for a Writ of Certiorari.

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[4] *Asahi Metal Indus. Co., Ltd. v. Superior Court of California, Solano County*, 480 U.S. 102, 113 (1987) (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945) (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940))).

CONCLUSION

The decision of the court below would substantially extend the reach of state taxing powers to companies having no contact with the taxing state by interpreting significant constitutional limits on these powers so narrowly as to effectively eliminate them. In addition, this case squarely presents for decision an important issue left unresolved by *Quill*, *i.e.*, whether the physical-presence test reaffirmed by *Quill* applies to state taxes other than sales and use taxes. Many thousands of businesses will be significantly affected by the resolution of these issues and are highly vulnerable to continuing uncertainty and substantial tax and compliance burdens in the absence of guidance from this Court. For these reasons, the Petition for a Writ of Certiorari should be granted.

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Supreme Court, U.S.
FILED
NOV 1 1993
OFFICE OF THE CLERK

No. 93-520

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,
v.
SOUTH CAROLINA DEPARTMENT OF REVENUE AND TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

BRIEF *AMICUS CURIAE* OF INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, INC. IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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BRIEF *AMICUS CURIAE* OF INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA, INC. IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

INTEREST OF THE *AMICUS CURIAE* [1]

The Information Technology Association of America, Inc. ("ITAA") is the principal trade association of the nation's information technology industry. ITAA has more than 2400 direct and affiliated members, and it represents the interests of the more than 36,000 information technology companies nationwide that provide the private and public sectors with the products and services which facilitate the useful application of information technology. These products and services include application and sys-

[1] This brief is filed pursuant to Rule 37.2 of the Rules of the Court, accompanied by the written consent of all parties.

tems software for mainframe, mid-range, and personal computers; custom and contract software programming services; information systems integration services; and information processing services.

The products and services provided by the information technology industry are almost always intangible in nature. For example, computer software—instructions that direct a computer's operation—may be transferred by digital signals directly from the software producer's computer over telephone lines to the purchaser's computer so that the software never assumes a tangible form. Even when software is embodied in a physical medium, such as a floppy disk or magnetic tape, the physical medium typically has little independent economic significance. Moreover, the transfer of information technology in whatever form is usually accomplished by the owner's license of the intangible right to use such technology.

Because intangible products, services, and rights are the essence of the information technology industry, the ruling of the South Carolina Supreme Court in this case, if allowed to stand, will have an enormous and adverse impact on ITAA's membership and industry. The court ruled that a state could impose an income tax on a foreign corporation with no physical presence in the state if the corporation's licensee uses the corporation's intangible property in the state. Information technology companies have entered into millions of transactions by which they have licensed others to use intangible property in states where the technology companies themselves have no physical presence or other significant contacts. Transactions of this nature have historically not exposed ITAA's industry to income taxation in such states. However, if the South Carolina decision is allowed to stand, it would have a profound and immediate effect on ITAA's members. ITAA therefore has a strong interest in the issues presented in the Petition for a Writ of Certiorari and the outcome of the case.

SUMMARY OF ARGUMENT

The decision below expands the concept of state taxing jurisdiction well beyond the constitutional restraints on which ITAA's members and other taxpayers have reasonably relied. If left undisturbed, the decision would have a devastating impact on the information technology industry by exposing thousands of companies to taxation in states in which their intangible property is licensed but with which they have no other palpable connection. The resulting harm to the interstate market in information technology would likely be substantial as industry members were compelled to absorb unanticipated tax liabilities and to comply with unfamiliar tax laws across the country. As a result, we respectfully submit that the Court should make it clear that the "substantial nexus" requirement of the Commerce Clause bars a state from taxing a foreign corporation with no physical presence in the state merely because the corporation's intangible property is used in the state by its licensees.

ARGUMENT

BY SUBJECTING AN OUT-OF-STATE LICENSOR TO STATE INCOME TAXATION IN ANY STATE IN WHICH A LICENSEE USES THE LICENSOR'S INTANGIBLE PROPERTY, THE DECISION BELOW IGNORES THE CONSTITUTIONAL RESTRAINTS ON STATE TAX JURISDICTION AND THEREBY THREATENS TO INFLICT SERIOUS HARM ON THE INTERSTATE MARKET IN INFORMATION TECHNOLOGY

Petitioner and other *amici* have apprised the Court of the significant legal issues raised by this case, and ITAA will not burden the Court with a recapitulation of those arguments, although it subscribes to them in full. ITAA seeks instead to bring one additional point to the Court's attention: If the rule of law announced by the South Carolina Supreme Court is allowed to stand, it threatens to have a disastrous impact on the information technology

industry which has reasonably relied on its Commerce Clause immunity from state income taxation in states where it does no more than license others to use intangible property.

A. The Law on Which the Information Technology Industry Has Reasonably Relied

Prior to *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992), this Court had never seriously suggested, let alone held, that a taxpayer who was not physically present in a state could be compelled to pay a tax in that state given the restraints that the Commerce Clause imposes on state taxing authority. The "bright-line, physical-presence requirement" (*id.* at 1916) of *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), fairly characterized the Court's Commerce Clause jurisprudence at that time, and in cases decided over the next 25 years the Court never cited *Bellas Hess* with anything but approval. *See, e.g., Goldberg v. Sweet*, 488 U.S. 252, 263 (1989); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 33 (1988); *National Geographic Soc'y v. State Bd. of Equalization*, 430 U.S. 551, 559-60 (1977).

To be sure, the Court in *Quill* agreed with the state court's observation that some of this Court's more recent cases had "signalled a 'retreat from the formalistic constrictions of a stringent physical presence test . . . .'" *Quill*, 112 S. Ct. at 1914 (quoting *State v. Quill Corp.*, 470 N.W.2d 203, 214 (N.D. 1991)). But the Court nevertheless recognized that all of the cases the state court had invoked for this proposition "involved taxpayers who had a physical presence in the taxing state and therefore do not directly conflict with the rule of *Bellas Hess* . . . ." *Id.* at 1914. Indeed, the Court in *Quill* explicitly acknowledged that the licensing of software by an out-of-state licensor of information technology to an in-state licensee does not "comprise the 'substantial nexus'

required by the Commerce Clause." *Id.* at 1907 n.1. The Court further declared in *Quill* that:

> The State "concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus." . . . We agree. Although title to "a few floppy diskettes" present in a State might constitute some minimal nexus, in *National Geographic Society v. California Bd. of Equalizaton*, 430 U.S. 551, 556 (1977), we expressly rejected a " 'slightest presence' standard of constitutional nexus." We therefore conclude that Quill's licensing of software in this case does not meet the "substantial nexus" requirement of the Commerce Clause.

Id. at 1914 n.8.

In light of the clear rule of law prior to the Court's decision in *Quill* that physical presence was a necessary condition to the assertion of state tax jurisdiction, it would have taken considerable omniscience for a taxpayer to foresee that the Court, in 1992, would reaffirm the bright-line, physical-presence standard of "substantial nexus" under the Commerce Clause for sales and use taxes while leaving open the question whether this Commerce Clause standard applied with equal force to other types of taxes, including income taxes. Accordingly, members of the information technology industry were entirely justified, at least prior to this Court's decision in *Quill*, in relying on the settled rule that physical presence in a state was an essential prerequisite to the power of a state to tax a foreign corporation.

B. The Effects on the Information Technology Industry of Allowing the Decision Below To Stand

If the decision below is allowed to stand, and with it the rule that the licensor of intangible property is subject to tax wherever its licensee uses the property, the impact on the information technology industry would be swift and harsh. It is no secret that tax administrators across

the country are poised to use the decision below to their full advantage should the Court deny review. *See* Pet. at 20-22.[2] Consequently, should the Court decline to review the decision below, ITAA's members can expect an immediate response from state tax administrators.

Moreover, no industry is more vulnerable to the adverse consequences of the taxing authorities' widespread embrace of the South Carolina decision than the information technology industry. The dominant mode of conducting business in the information technology industry is through the licensing of intangible assets in order to protect the developers' intangible intellectual property rights. "The vast majority of software vendors," for example, offer their products through a "perpetual license." Culpepper & Associates, *Software Pricing Trends* 181 (1990). Thus, a typical software license provides that "Licensor grants to Licensee, and Licensee accepts from Licensor, a perpetual non-exclusive and non-transferable license to use the current version of Licensor's software." Richard Raysman and Peter Brown, *Computer Law: Drafting and Negotiating Forms and Agreements* § 7.15 (1991).

Under the reasoning of the decision below, software producers across the country will suddenly find themselves subject to the taxing jurisdiction of every state in which their licensees use the software, even though the technology producers have no other contact with the taxing state. Not only will such liability be wholly unanticipated (*see supra* pp. 4-5), it will also be wholly unpredictable. A software producer that licensed its product to a licensee in State A will unexpectedly find itself subject to income tax jurisdiction in State B when its licensee moves from State A to State B. Furthermore, software licensed to a customer in State A may be copied and distributed, under the terms of the license, both within the customer's own organization and to third parties all over the world,

[2] All citations to the Petition for a Writ of Certiorari are designated "Pet." followed by a page reference.

thereby exposing the licensor to taxation in a multitude of jurisdictions.

The burden on software producers to comply with the tax laws of all the states in which their licensees are located at the time the license agreement is consummated would be onerous enough. If, in addition, the producers are required to monitor their licensees' *future* activities to determine the states from which the producers might at some future time be deemed to be deriving the "benefit of economic contact" (Pet. App. A at 5a), it would be overwhelming. If the "substantial nexus" requirement of the Commerce Clause means anything, it must be that it prohibits the erosion of the free trade purposes underlying the Clause that would be caused by an acceptance of the sweeping conception of state taxing jurisdiction embodied in the decision below.

Software producers are not the only members of the information technology industry that would be devastated by the repercussions of the South Carolina court's decision. Local and network-based data processors, database providers, and systems integrators would suffer similar problems. If the use by another of a producer's intangible property is a proper predicate for state tax jurisdiction over the producer, these information technology providers will confront staggering burdens. They would be required to comply with the state tax laws of every state in which their customers, often with multiple locations, used the information technology, because, at least in the eyes of the court below, they would have "been aware of, consented to, and benefitted from" (Pet. App. A at 5a) their customers' use of their intangibles in the taxing state.

Perhaps the most pernicious aspect of the decision below from the standpoint of the information technology industry is the tremendous uncertainty it has already spawned regarding the industry's past and future state tax payment and reporting obligations. Since industry members have been operating under the reasonable as-

sumption that the mere licensing of intangible property to others did not subject them to income tax jurisdiction in the states where their licensees used the property, *see supra* pp. 4-5, they have not filed income tax returns in states where their only connection is the "presence" of their intangible property in the hands of their licensees. Because taxpayers who failed to file returns are not protected by statutes of limitations, the information technology industry faces potentially crushing past tax liabilities if the decision below stands and is applied retroactively, as this Court's decisions suggest it well could be. *See Harper v. Virginia Dept. of Taxation*, 113 S. Ct. 2510 (1993).

Uncertainty regarding the future application of the decision below, if not reversed by this Court, is as troublesome as the specter of its retroactive application. Once unleashed, the principle enunciated by the South Carolina court knows no bounds. For an industry whose principal product is intangible property, and whose basic transaction is the license of such property, the prospect that the use by another of one's intangible property provides a constitutional predicate for the exercise of state taxing authority is a cause for immense concern. Virtually every agreement entered into by even the smallest producer of information technology will expose the producer to taxation in every state where his customer uses—or in the future chooses to use—the license. Under the principle upon which the decision below is based, this is so regardless of any other contacts that the taxpayer may have with the taxing state because it is the intangible assets themselves, not the owner's concrete activities in producing or protecting those assets, that provide the foundation for state tax jurisdiction. Furthermore, in light of the fact that intangible property is not susceptible to precise geographical identification, and many different states can often lay a legitimate tax claim to the same intangible, *Curry v. McCanless*, 307 U.S. 357, 372-74 (1939), or the income it generates, *Guaranty Trust Co. v. Virginia*, 305 U.S. 19, 22-23 (1938), there is no natural limit to the cumulative

tax burdens that would confront the information technology industry if the decision below is left undisturbed.

CONCLUSION

Because the decision below will create severe, unwarranted, and unanticipated burdens on the information technology industry, ITAA urges the Court to grant the Petition for a Writ of Certiorari and thereafter reverse the decision of the Supreme Court of South Carolina.

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Dated: November 1, 1993

Supreme Court, U.S.
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BRIEF OF AMICUS CURIAE TAX EXECUTIVES INSTITUTE, INC. IN SUPPORT OF PETITIONER

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BRIEF OF AMICUS CURIAE TAX EXECUTIVES INSTITUTE, INC. IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of the petition for a writ of certiorari.[1] Tax Executives Institute (hereinafter "TEI" or "the Institute") is a voluntary, non-profit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. TEI was organized in 1944 and has approximately 4,900 members who represent more than 2,400 of the leading corporations in the United States and Canada.

TEI is dedicated to promoting the uniform and equitable enforcement of the tax laws throughout the Nation, to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and to vindicating the Commerce Clause and other constitutional rights of all business taxpayers. The members of the Institute represent a cross-section of the business community, and almost without exception, the companies represented by the Institute's membership are engaged in interstate commerce. Thus, substantially all TEI members will be directly affected by the Supreme Court's decision whether to grant a writ of certiorari in this case.

The issue presented in this case is whether the Commerce and Due Process Clauses preclude South Carolina and other States from taxing the income of a corporation whose presence in the state is not physical, but involves only the use of its trademark (or other intangible property) by a licensee. The case raises the question spe-

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[1] TEI has requested and received the written consents of the Petitioner and the Respondent to the filing of this brief; those consents have been filed with the Clerk of this Court.

cifically reserved by the Supreme Court in *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992): Whether *Quill*'s bright-line nexus test (which requires a physical presence in the State) applies to taxes other than sales and use taxes. It also raises questions about the scope of the Court's holding in *Quill* that the Due Process Clause does not preclude the taxation of a taxpayer who, although not physically present within a State, has "purposefully directed" its activities at the State. Finally, it brings into doubt the effectiveness of Public Law No. 86-272, 73 Stat. 555 (codified at 15 U.S.C. § 381 (1988)), which circumscribes the States' power to tax income derived from interstate sales of tangible personal property, as interpreted by the Court in *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992).

Because TEI members and the companies by whom they are employed will be materially affected by the Court's disposition of these issues, the Institute has a special interest in this case.

SUMMARY OF ARGUMENT

The core issue presented by this case is whether the use of Geoffrey, Inc.'s intangible interests by a third party in South Carolina subjected the corporation to income tax in the State. With minimal analysis, the South Carolina Supreme Court answered this question yes. The lower court's holding casts a shadow over the protections accorded interstate businesses by the Constitution.

1. A threshold requirement of the Commerce Clause is the presence of "sufficient nexus" between the State and the person, property, or transaction to be taxed. Absent such a connection, the tax will be struck down as unconstitutional. Two terms ago in *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992), the Court addressed whether the nexus requirements of the Due Process and Commerce Clauses are co-extensive. It found that while "a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause." *Id.* at 1909.

Quill effectively harmonized the Court's decision in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977), with the Court's 1967 decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), which held that a vendor's physical presence in a State was required before a sales and use tax obligation could be imposed. Even though *Quill* overruled *National Bellas Hess*'s due process holding, it reaffirmed that a vendor whose only contacts with the taxing States are by mail or common carrier lacks the substantial nexus required by the Commerce Clause to be subject to sales and use tax. *Id.* The Court in *Quill* did not explicitly extend its holding beyond the sales and use tax area, but it cautioned that its failure to articulate a physical-presence test in other areas "does not imply repudiation of the [*National*] *Bellas Hess* rule" in those areas. *Id.* at 1914.

2. The court below paid scant attention to the reasoning and mandate of this Court's decision in *Quill*, and did not analyze whether and why income taxes should be treated differently from sales and use taxes.

Amicus TEI submits that they should not: A bright-line, physical-presence test should be adopted to avoid "undue burdens on interstate commerce . . . by the demarcation of a discrete realm of commercial activity that is free from interstate taxation." *Id.* at 1914. Such a test would firmly establish the boundaries of legitimate state authority, reduce litigation, encourage settled expectations, and promote stability and the orderly development of the law. *See id.* at 1915-16. Indeed, ample grounds exist for imposing a *higher* nexus standard in respect of income taxes.

The lower court's analysis resembles that of the lower court in *Quill*, which had argued that an "economic presence" test should be applied. The South Carolina court held that the nexus requirement of the Constitution was satisfied merely by the "presence" of intangible property in South Carolina, making specific reference to Geoffrey's accounts receivable in the State. This chimerical nexus test should be rejected as a one-way street to ration-

alize taxing schemes, not to vindicate the Commerce Clause rights of interstate taxpayers. Moreover, the test propounded by the South Carolina court is unreasonably vague, and would impose undue administrative costs and burdens on interstate business.

Under the South Carolina court's analysis, the sale of any type of property (tangible or intangible) or service on credit could arguably subject an out-of-state seller to income tax, regardless of whether the seller had any presence (physical or otherwise) in the State. The lower court's jurisdictional alchemy would massively expand the obligation of taxpayers to comply with a plethora of state tax filing obligations. It was concerns with such administrative costs and burdens that informed the Court's Commerce Clause analysis in *Quill*, and that led the Court to affirm the vitality of the physical-presence test in respect of sales and use tax. Such concerns, regrettably, were lost on the court below. A writ of certiorari should be issued in this case to remedy that shortcoming and to confirm the application of a bright-line, physical-presence test to income tax cases.

3. In *Quill*, this Court decoupled the constitutional requirement of nexus for Commerce Clause purposes from the nexus requirement for due process purposes. It did not, however, read the Due Process Clause's requirement of nexus out of the Constitution. Rather, it affirmed that a State may subject a foreign corporation to its taxing jurisdiction only if the taxpayer had "minimum contacts" with the jurisdiction.

The South Carolina Supreme Court had little trouble in concluding that the Due Process Clause posed no barrier to the State's assertion of taxing power. The lower court, however, failed to point to any activity of Geoffrey in South Carolina; rather, it focused on activities of its licensee. Clearly, the taxpayer's "contacts" with the State are far less substantial than Quill Corporation's "continuous and widespread solicitation of business within [the] State." *Quill Corp.*, 112 S. Ct. at 1911.

Whereas Quill Corporation's contacts in North Dakota were "more than sufficient" for due process purposes, 112 S. Ct. at 1911, the same cannot be said in respect of Geoffrey's minimal contacts here. The Court should issue a writ of certiorari to vivify the Due Process Clause's limitations on the States' authority to tax.

4. The theory of nexus propounded by the court below is potentially so loose that it could undercut the protections accorded interstate business by Public Law No. 86-272, 73 Stat. 555 (codified at 15 U.S.C. § 381 (1988)), which prohibits the States from taxing the income of a corporation whose only business activities within the State consist of solicitations of orders for sales of tangible personal property. The protections intended by Congress and fortified by the Court two terms ago in *Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992), however, could well be diluted if the lower court's opinion is allowed to stand.

The court below found the presence of intangible property in South Carolina by virtue of the taxpayer's licensing of trademarks and other intangibles as well as the presence of accounts receivable. If the presence of such "intangible property" were construed to be more than "solicitation" for purposes of Public Law No. 86-272 or to render the law inapplicable, the federal statute would be effectively gutted.

Amicus TEI submits that the Court should issue a writ of certiorari to ensure that the States do not act to frustrate the congressional policy underlying Public Law No. 86-272.

ARGUMENT

The petitioner, Geoffrey, Inc., is the owner of several trade names and trademarks, including "Toys 'R' Us." Geoffrey licensed these trade names and trademarks to Toys "R" Us stores throughout the country, including South Carolina. Under the licensing agreement, Toys "R" Us paid Geoffrey a fee, or royalty, based on total company sales. Geoffrey had no employees, offices, or physical presence within South Carolina, and at the time the licensing agreement was entered into, there were no Toys "R" Us stores located in the State.

The core issue presented by this case is whether the use of Geoffrey's intangible interests in South Carolina subjected the corporation to income tax in the State. With minimal analysis, the South Carolina Supreme Court answered this question yes. It averred that a "taxpayer need not have a tangible, physical presence in a state for income to be taxable" and blithely sought to distinguish this Court's 1992 holding in *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992)—which requires such a physical presence—on the ground that *Quill* involved sales and use taxes (rather than income taxes). App. A at 9a & n.4.[2] The South Carolina court also held that "by licensing intangibles for use in this State and deriving income for their use here, Geoffrey has a 'substantial nexus' with South Carolina." App. A at 10a (footnote omitted).

The holding of the court below casts a long shadow over the protections accorded interstate businesses by both the Commerce and Due Process Clauses of the Constitution.[3] The South Carolina court misapprehended this Court's

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[2] References to "App." are to the appendix filed with Geoffrey, Inc.'s Petition for a Writ of Certiorari to the Supreme Court of South Carolina (No. 93-520).

[3] U.S. Const. art. I, § 8, cl. 3 (Commerce Clause); U.S. Const. amend. XIV, § 1 (Due Process Clause).

decision in *Quill* in two respects: First, it erroneously concluded that the bright-line, physical-presence test embraced by the Court for Commerce Clause purposes has no application in respect of income taxes. Secondly, it misconstrued the limitations the Due Process Clause imposes on States, notwithstanding this Court's finding that the Due Process Clause's nexus requirement is not coextensive with the Commerce Clause's analogous requirement. Thus, under the lower court's analysis, the States would be free to tax even where taxation would offend "traditional notions of fair play and substantial justice." *See Quill Corp.*, 112 S. Ct. at 1910 (quoting *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945)). Moreover, by conjuring nexus between a licensor and the State out of a *licensee*'s use of a trademark, the lower court set forth a standard so amorphous and vague that it could not help but subvert basic Commerce Clause principles. Moreover, to the extent the intangible property is imbedded in tangible property, the decision below undermines the statutory protection afforded interstate businesses by Public Law No. 86-272, 73 Stat. 555 (codified at 15 U.S.C. § 381 (1988)). *See Wisconsin Dep't of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447, 2453-54 (1992).

The court should grant a writ of certiorari in order to turn back this effort by the State of South Carolina to vitiate the Court's recent holdings in *Quill* and *Wrigley* and thereby frustrate interstate commerce.

I.

The "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several States." *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 335 (1977). In tandem with the Due Process Clause of the Fourteenth Amendment, the Commerce Clause acts to prevent the States from enacting unfair

tax or tax collection statutes and thereby imposing "unreasonable clog[s] upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935); *see* PAUL J. HARTMAN, FEDERAL LIMITATIONS ON STATE AND LOCAL TAXATION §§ 2.2, 2.1 (1981).

Because the Commerce Clause was intended to protect "the free flow of trade between the States," "[s]tate taxation falling on interstate commerce . . . can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys." *Freeman v. Hewit*, 329 U.S. 249, 252, 253 (1946). In determining whether a particular state taxing scheme is constitutionally valid, this Court has held that "due process requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." *Miller Bros. v. Maryland*, 347 U.S. 340, 344-45 (1954). In *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), the Court cited *Miller Bros.* with approval and imported its "definite link, some minimum connection"—or nexus—standard into its Commerce Clause analysis. *Id.* at 756, *quoting Miller Bros.*, 347 U.S. at 344-45.

The overarching importance of nexus to Commerce Clause determinations is underscored by the Court's seminal decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and its holding two terms ago in *Quill*. In *Complete Auto Transit*, the Court established a four-prong test for determining whether a state tax statute violates the Commerce Clause, holding that such a tax will be sustained only if (1) it is applied to an activity with a substantial nexus with the taxing State, (2) it is fairly apportioned, (3) it does not discriminate against interstate commerce, and (4) it is fairly related to the services provided by the State. *Id.* at 279. Thus, *Complete Auto Transit* sets forth a decisional framework for Commerce Clause inquiries that requires a balancing of competing interests in determining whether the tax unduly infringes on interstate commerce. *See, e.g., Trinova Corp.*

v. Michigan Dep't of Treasury, 498 U.S. 358, 372-73 (1991); *Exxon Corp. v. Department of Revenue*, 447 U.S. 207, 227-28 (1980).

A threshold requirement of the Commerce Clause is the presence of "sufficient nexus" between the State and the person, property, or transaction to be taxed. Absent such a connection, the "fairness" of the particular levy—measured in terms of whether it is properly apportioned or whether it is reasonably related to the services provided by the State—is irrelevant: The tax will be struck down as unconstitutional. *See Quill Corp.*, 112 S. Ct. at 1909; *Trinova Corp.*, 498 U.S. at 372-73; *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 436-37 (1980). In other words, if the connection, or linkage, is insubstantial or remote, the State has not "given anything for which it can ask return," *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435, 444 (1940), and the State's effort to assert its taxing authority must be turned aside.

Two terms ago in *Quill*, the Court addressed whether the nexus requirements of the Due Process and Commerce Clauses are co-extensive.[4] The Court severed the two standards, explaining that they are "animated by different constitutional concerns and policies":

> [T]he due process nexus analysis requires that we ask whether an individual's connections with a State are substantial enough to legitimate the State's exercise of power over him. . . . In contrast, the Commerce Clause, and its nexus requirement, are informed not so much by concerns about fairness for the individual defendants as by structural concerns

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[4] The Court elaborated that "'[t]here may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce.'" 112 S. Ct. at 1909 (quoting *International Harvester Co. v. Department of Treasury*, 322 U.S. 340, 353 (1944) (Rutledge, J., concurring in part and dissenting in part)).

about the effects of state regulation on the national economy.

112 S. Ct. at 1913.[5]

Quill confirmed the vitality of the *Complete Auto Transit* construct and effectively harmonized that decision with the Court's 1967 decision in *National Bellas Hess*, which had held that a sales and use tax could not constitutionally be imposed on a vendor whose only contacts with the taxing State are by mail or common carrier.[6] It also reaffirmed the constitutional prerequisite (for Commerce Clause purposes) of the taxpayer's physical presence in the taxing jurisdiction, though it overruled *National Bellas Hess*'s due process holding. *Quill Corp.*, 112 S. Ct. at 1916. Thus, *Quill* confirmed that a vendor whose only contacts with the taxing State are by mail or common-carrier lacks the substantial nexus required by the Commerce Clause. *Id.* The Court embraced *National Bellas Hess*'s bright-line, physical-presence test of Commerce Clause nexus not only because such a test "furthers the ends of the dormant Commerce Clause" by "demar-

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[5] Thus, "a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, [while] imposition of the tax may nonetheless violate the Commerce Clause." *Id.*, at 1909 (citing *Tyler Pipe Industries, Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987)). In differentiating the two standards, the Court in *Quill* noted that "the 'substantial-nexus' requirement is not, like due process' 'minimum-contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce." 112 S. Ct. at 1913.

[6] In *National Bellas Hess*, the Court struck down Illinois's effort to require an out-of-state mail-order business to collect the use tax on mail-order sales made to state residents on both due process and Commerce Clause grounds. The Court explained that sanctioning the imposition of a use tax collection duty on a business that maintained no physical presence in the State would give rise to "unjustifiable local entanglements" of interstate commerce. 386 U.S. at 760. The Court reasoned that the administrative and record-keeping requirements that could arise in the absence of a physical presence test "could entangle National [Bellas Hess]'s interstate business in a virtual welter of complicated obligations to local jurisdictions . . . ." *Id.* at 759-60.

cati[ng] . . . a discrete realm of commercial activity that is free from interstate taxation," *id.* at 1914, but because it fosters the "interest in stability and orderly development of the law" that undergirds the doctrine of *start decisis*. *Runyon v. McCrary*, 427 U.S. 160, 190-91 (1976) (Stevens, J., concurring) (quoted in *Quill Corp.*, 112 S. Ct. at 1916).[7] The Court in *Quill* did not explicitly extend its holding beyond the sales and use tax area, but it cautioned that its failure to articulate a physical-presence test in other areas "does not imply repudiation of the [*National*] *Bellas Hess* rule" in those areas. *Id.* at 1914.

II.

The court below paid scant attention to the reasoning and mandate of the decision in *Quill*. Rather, it embarked on a results-oriented journey very similar to the North Dakota trip that the Court in *Quill* found to contravene the Commerce Clause. Holding that "[t]he presence of intangible property alone is sufficient to establish nexus," App. A at 9a, the South Carolina court dismissed *Quill* with a wave of its hand, noting only that this Court had observed that, to date, the physical-presence test had not been extended beyond the sales and use tax area. App. A at 9a n.4. Thus, the lower court gave no weight to the statement in *Quill* that the failure to articulate a physical-presence test in other areas "does not imply repudiation of the [*National*] *Bellas Hess* rule" in respect of income taxes. 112 S. Ct. at 1914. More to the point, it did not analyze whether and why income taxes should be treated differently from sales and use taxes.

Amicus TEI submits that they should not: A bright-line, physical-presence test should be adopted to avoid "[u]ndue burdens on interstate commerce . . . by the demarcation of a discrete realm of commercial activity that is free from interstate taxation." *Id.* at 1914. Such a test

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[7] "[T]he continuing value of a bright-line rule in this area and the doctrine and principles of *stare decisis* indicate the [*National*] *Bellas Hess* rule remains good law." *Quill Corp.*, 112 S. Ct. at 1916.

would firmly establish the boundaries of legitimate state authority, reduce litigation, encourage settled expectations, and promote stability and the orderly development of the law. *See id.* at 1915-16.

Indeed, ample grounds exist for concluding that the nexus requirement for income tax purposes is *more* demanding than the requirement for sales and use tax purposes. Unlike sales and use taxes, which are transaction-based, the authority to impose an income tax is predicated on a taxpayer's own links to the taxing jurisdiction—that is to say, whether the taxpayer is sufficiently present, or active, in the State (and derives sufficient benefits from the State) to satisfy the Constitution's minimum contacts requirement. The transactions being taxed under a sales and use taxing scheme are themselves a link between the taxpayer and the State, a connection that must be buttressed by the taxpayer's physical presence in order to survive constitutional scrutiny. Where the tax is imposed not on transactions but on income, an even-more-substantial connection should be required.[8]

The need for as high or even a higher standard of constitutional nexus for income tax purposes is underscored by Congress's enactment of Public Law No. 86-272, which prohibits States from taxing income derived from interstate sales of tangible personal property if the only activities of the out-of-state person within the State are the solicitation of orders. Although the prohibition in Public Law No. 86-272 is not absolute, the legislation does evidence Congress's intent to erect a higher barrier to state *income* taxation to ensure that the States' taxing schemes do not unduly impede interstate commerce. Ratification of, or acquiescence in, the lower court's analysis would so impede interstate commerce.[9]

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[8] Thus, it is not at all uncommon for taxpayers to pay sales and use taxes (on a transactional basis) in more jurisdictions than those in which they are required to register and pay income taxes.

[9] For a further discussion of Public Law No. 86-272, see part IV of the Argument.

That the bright-line test of *Quill* should be extended to the income tax area is made manifest by what the lower court did in the absence of such a test. The court held that the nexus requirement was satisfied merely by the "presence" of "intangible property" in South Carolina, making specific reference to Geoffrey's accounts receivable (for licensing fees) created on the sales by the licensee, App. A at 5a, as well as to the "franchise" the court held was created by the agreement that permitted the licensee to sell a product or service under a trademark or trade name owned by the licensor. App. A at 5a & n.2. The court's analysis thus resembles that of the lower court in *Quill*, which had spuriously argued that a makeweight "economic presence" test should suffice for Commerce Clause purposes.

If such a standard (however denominated) were to come into force, however, the Commerce Clause rights of interstate business as a whole would be jeopardized for two reasons: First, intangible property rights are so prevalent in today's economy that the test would give States a sweeping license to tax broad classes of businesses without regard to whether they have, as a practical matter, substantial contacts with, or economic activity in, the taxing jurisdiction. In other words, this chimerical nexus test would operate as a one-way street to rationalize taxing schemes, not to vindicate the Commerce Clause rights of interstate taxpayers. Secondly, the test propounded by the South Carolina court is at once both unreasonably vague and unacceptably broad, and would impose undue administrative costs and burdens on interstate business.

The South Carolina Supreme Court would apply what might be called the Willie Sutton test of constitutional adjudication: *Why does the State assert that it has sufficient nexus to impose an income tax on Geoffrey? Because Geoffrey is where the money is.* Thus, in defending its finding of nexus, the court baldly stated:

> That Geoffrey has received protection, benefits, and opportunities from South Carolina [sufficient to jus-

> tify a finding of nexus] is manifested by the fact that it earns income in this state.

App. A at 9a. In other words, because there is income to be taxed, it must be taxable by the State of South Carolina. Surely this tautology cannot pass constitutional muster.

To be sure, the lower court identified "intangible property" within the State that it said justified its conclusion, but in point of fact Geoffrey itself engaged in no business activity within South Carolina. More fundamentally, the lower court's standard is so broad that it would sweep an extraordinary amount of out-of-state businesses within its taxing net. Consider what would give rise to tax and who would be taxable under the lower court's analysis. Every sale of a Mickey Mouse T-shirt or a personal computer with MS-DOS and Windows installed and "Intel inside" would give rise to a royalty or licensing fee subject to tax. Indeed, whenever one person's intangible property (be it a copyright, trademark, trade name, patent, or some similar property) was used by others, the person would be subject to tax where the property was used—regardless of whether the person had any say in the matter—and to the attendant filing and compliance costs.

Movie stars who receive a percentage of ticket sales would be taxable in every jurisdiction in which their films are shown. A musician who receives a royalty on the sale of records or compact disks would be subject to tax in every State in which a sale is made, as would authors whose publishing contracts call for a per-book royalty.[10] Hence, pop singer Phil Collins would be subject to tax in each State in which a copy of his recording "In the Air Tonight" is sold and mystery writer Mary Stewart would find herself subject to tax in each State in which a reader buys *Airs Above the Ground*—an ironic result

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[10] Query whether authors receiving payments from the Copyright Clearance Center in respect of copies of articles published in academic journals (and elsewhere) would find themselves subject to tax in those jurisdictions from which the payments were made.

perhaps inasmuch as the States would seem to be conjuring nexus out of thin air.[11]

South Carolina's concept of nexus is further distended by the lower court's intimation that accounts receivable constitute intangible property sufficient to support the State's assertion of taxing power. App. A at 5a-6a. Hence, the sale of any type of property (tangible or intangible) or service on credit could arguably subject an out-of-state seller to income tax, regardless of whether the seller had any presence in the State. Such an expansive, ethereal definition of nexus would leave the States free to wield "intangible property" as a shibboleth to eviscerate the protections of the Commerce Clause. In other words, the nexus requirement as interpreted by the lower court would become little more than the word "glory" in *Through the Looking Glass:* meaning whatever the States, like Humpty Dumpty, says it means.[12]

The lower court's jurisdictional alchemy would massively expand the obligation of taxpayers to comply with a plethora of state tax filing obligations. Businesses that received income from other persons' use of their intangible property would have to monitor where such property was used, determine what part of the income derived from such use was attributable to which jurisdiction, research the tax consequences of such use in each jurisdiction, and then undertake to comply. They would likely have to revise their licensing agreements, change their accounting systems to capture the necessary information, and set in

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[11] In *Quill*, this Court found that Quill Corporation's licensing of software to some North Dakota customers did not satisfy the Commerce Clause's "substantial nexus" requirement. 112 S. Ct. at 1914 n.8. The Court confirmed that more than a "slightest presence" standard—such as it rejected in *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551, 556 (1977)—is required under the Constitution. 112 S. Ct. at 1914 n.8.

[12] LEWIS CARROLL, THROUGH THE LOOKING GLASS 186 (Signet Classic 1960) ("'When *I* use a word ['glory'],' Humpty Dumpty said, in a rather scornful tone, 'it means just what I choose it to mean—neither more nor less.'").

place procedures to ensure compliance with myriad filing and reporting requirements. None of these tasks would be easy, and none would be cheap. The burden of uncertainty, exacerbated by the cost of good faith compliance efforts, could not help but act as an "unreasonable clog upon the mobility of commerce." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. at 527.

It was concerns with administrative costs and burdens that informed the Court's Commerce Clause analysis in *Quill*, and such concerns that led the Court to affirm the vitality of the physical-presence test in respect of sales and use tax. Such concerns, regrettably, were lost on the court below. A writ of certiorari should be issued to remedy that shortcoming by confirming the application of a bright-line, physical-presence test to income tax cases.

III.

In *Quill*, this Court decoupled the constitutional requirement of nexus for Commerce Clause purposes from the nexus requirement for due process purposes. Even though the Court held that due process jurisprudence had evolved beyond an absolute prerequisite of physical presence, it did not read the Due Process Clause's requirement of nexus out of the Constitution. Rather, it affirmed that a State may subject a foreign corporation to its taxing jurisdiction only if the taxpayer had "minimum contacts with the jurisdiction" to ensure against offending "traditional notions of fair play and substantial justice." 112 S. Ct. at 1910 (quoting *International Shoe Co.*, 326 U.S. at 316); *accord Milliken v. Meyer*, 311 U.S. 457, 463 (1940).[13]

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[13] In other words, the due process nexus requirement was not rendered a nullity; a taxpayer's "purposefully avail[ing] itself of the benefits of an economic market in the forum State" and "purposefully direct[ing]" its activities at residents of that State are simply now to be considered in determining whether the assertion of jurisdiction would comport with "fair play and substantial justice." 112 S. Ct. at 1910, 1911 (citing *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985)); *see International Shoe*, 326 U.S. at 320.

The South Carolina Supreme Court had little trouble concluding that the Due Process Clause posed no barrier to the State's assertion of taxing power over Geoffrey. It reached this conclusion, however, by turning the "purposefully directed" test on its head. Specifically, the lower court did not point to any activity of Geoffrey in South Carolina, but rather to activities of its licensee. It then averred that "Geoffrey had not been unwillingly brought into contact with South Carolina through the unilateral activity of an independent party." App. A at 5a. Clearly, however, Geoffrey's "contacts" with South Carolina are far less substantial than Quill Corporation's "continuous and widespread solicitation of business" within North Dakota. 112 S. Ct. at 1911. More fundamentally, the Court in *Quill* observed that a company engaging in such extensive solicitations "has 'fair warning that [its] activity may subject [it] to the jurisdiction of a foreign sovereign.'" *Id.* at 1911 (quoting *Shaffer v. Heitner*, 433 U.S. 186, 218 (1977) (Stevens, J., concurring) (brackets in original)). Where was the warning here?

Thus, whereas Quill Corporation's contacts in North Dakota were "more than sufficient" for due process purposes, 112 S. Ct. at 1911, the same cannot be said in respect of Geoffrey's contacts here. Indeed, the lower court ignored the second prong of the Court's due process analysis: whether the assertion of taxing jurisdiction comports with traditional notions of fair play and substantial justice. This may not be surprising given Geoffrey's attenuated connection with the State, but neither should it stand. *Amicus* TEI urges the Court to issue a writ of certiorari to vivify the Due Process Clause's limitations on the States' authority to tax.

IV.

The theory of nexus propounded by the court below is so open-ended that it could significantly undercut the protections accorded interstate business by Public Law No. 86-272. That law, which was enacted by Congress in

1959 in furtherance of its responsibility to regulate interstate commerce, prohibits the States from taxing the income of a corporation whose only business activities within the State consist of "solicitations of orders . . . for sales of tangible personal property," where the orders are sent outside the State for approval and the goods are delivered from out-of-state. *Id.*; *see Wrigley*, 112 S. Ct. at 2450. The legislation, however, does not extend to sales of services or intangible property.

Two terms ago, the Court in *Wrigley* brought considerable clarity to Public Law No. 86-272 by interpreting the term "solicitation." The protections intended by Congress and fortified by the Court in *Wrigley*, however, could well be diluted if the lower court's opinion is allowed to stand. As previously stated, the court found the presence of intangible property in South Carolina by virtue of the taxpayer's licensing of trademarks and other intangibles as well as the presence of accounts receivable in respect of sales by the licensee. If the presence of such "intangible property" in the State were construed to be more than "solicitation" for purposes of Public Law No. 86-272, the federal statute would be effectively gutted. Similarly, where the sale of tangible personal property (otherwise falling within the ambit of Public Law No. 86-272) is bundled with a license to use intangible property (*e.g.*, a trademark, copyright, or patent)—as is quite common—the lower court's analysis could rob taxpayers of the protection of the statute, even though they hew closely to the guidelines set forth in *Wrigley*.

Consider the case of the manufacturer whose sales of tangible personal property are shielded from state income taxation on the grounds that its activities in the State do not extend beyond mere solicitation. If the property is stamped with the manufacturer's trademark, would a State be free, notwithstanding Public Law No. 86-272, to impose its income tax on the manufacturer on the basis of the use of the imbedded intangible property in the

State?[14] In the absence of guidance from the Court, the States may well act to frustrate the congressional policy undergirding Public Law No. 86-272.[15]

The potential dissonance among the Court's teaching in *Quill*, the Commerce Clause's nexus requirement for income tax purposes, and the scope of the federal statute —should the lower court's opinion stand—is illustrated by the following example.

> A musician writes, copyrights, and records several songs and regularly advertises their sale on cassette tapes through a national cable television station. Orders are received from residents of several States who pay by credit card, and the tapes are shipped through the mail or by common carrier. Under *Quill*, the musician is not obliged to collect the market States' use tax because the musician has no physical contacts with those States, other than through the mail or by common carrier. If the lower court's analysis applies for income tax purposes, however, the States could well assert jurisdiction to tax. Specifically, they could claim that Public Law No. 86-272 does not preclude their imposition of income tax because intangible personal property—the copyrighted music—was sold in addition to the tangible tapes.[16]

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[14] The merchandise subject to the Court's attention in *Wrigley*—chewing gum—clearly had intangibles (*e.g.*, the trade names Juicy Fruit and Doublemint) associated with it.

[15] There is evidence the States are poised to act. *See, e.g.*, Robert M. Fahrenbach, *DOR to Monitor* Geoffrey *Case, Intercompany Transactions*, 5 STATE TAX NOTES, July 26, 1993, at 300 (Wisconsin); William D. Townsend, *Revenue Department Drafts Substantial Rewrite of Corporate Income Tax Rules*, 5 STATE TAX NOTES, July 5, 1993, at 7 (Florida). *See generally* Federation of Tax Administrators, *South Carolina High Court Applies* Quill *Decision*, 57 TAX ADMINISTRATORS NEWS 69, 80 (July 1993) (the *Geoffrey* case "could become a basis for other state courts to hold companies subject to income and franchise taxes on the basis of economic presence").

[16] This illustration is based on an example set forth in Jeffrey S. Peters, *Commentary: Income Tax Nexus—Geoffrey Raises New Questions after Quill*, OHIO TAX SERV. 9-11, 9-12 (Dec. 1992).

Amicus TEI submits that the Court should issue a writ of certiorari and ensure that such a result will not obtain.

CONCLUSION

For the foregoing reasons, the Court should grant a writ of certiorari in this case.

Respectfully submitted,

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November 1, 1993

Supreme Court, U.S.
FILED
NOV 1 1993
OFFICE OF THE CLERK

No. 93-520

IN THE
Supreme Court of the United States
OCTOBER TERM, 1993

GEOFFREY, INC.,
Petitioner,

v.

SOUTH CAROLINA DEPARTMENT OF
REVENUE AND TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of South Carolina

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BRIEF OF AMICUS CURIAE NATIONAL RETAIL FEDERATION IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the "substantial nexus" requirement of the Commerce Clause or the "minimum contacts" requirement of the Due Process Clause precludes a state from imposing an income tax upon a corporation with no physical presence in the state but whose trademarks are used in the state by a licensee.

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BRIEF OF AMICUS CURIAE NATIONAL RETAIL FEDERATION IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE

The National Retail Federation ("NRF"), created to promote and protect the interests of the retail industry, is the largest national trade association of retailers. The retail industry itself consists of over 1.3 million U.S. retail establishments, employs nearly 20 million people, and registered sales in excess of $1.9 trillion in 1992. The NRF represents a wide spectrum of interests within that industry including the nation's leading department, chain, discount, specialty, and independent stores, several dozen national retail associations, and all 50 state retail associations.

The members of NRF are among the vast number of taxpayers who have relied upon the principle—previously

articulated and consistently applied by this Court—that a taxpayer's physical presence in a state is an essential prerequisite to the exercise of state tax power under the Commerce Clause. The South Carolina Supreme Court's decision in this case has placed this principle in jeopardy. The uncertainty and chaos in state tax administration that will inevitably result if the South Carolina court's decision is allowed to stand will directly affect the members of NRF as well as numerous other taxpayers. For example, taxpayers will be exposed to income tax in states in which they have no physical presence and in which they reasonably believed themselves immune from tax by this Court's prior rulings. Taxpayers will be required to reassess their business structure and compliance standards under the South Carolina court's novel conception of state taxing jurisdiction. NRF therefore has a strong interest in the issues presented in the certiorari petition.[1]

SUMMARY OF ARGUMENT

NRF urges this Court to grant review in this case for two reasons. First, the South Carolina Supreme Court's decision conflicts with the principle long applied by this Court, and relied upon by taxpayers everywhere, that physical presence is an essential component of state tax nexus under the Commerce Clause. Unless reviewed by this Court, the South Carolina court's assault on the "substantial nexus" criterion of the Commerce Clause will undermine fundamental restraints on state taxation of interstate commerce. Second, if left undisturbed, the South Carolina court's ruling will have an enormous adverse impact upon state taxpayers. Not only will the decision impose severe and unanticipated economic burdens upon taxpayers who have reasonably relied upon established principles of state tax jurisdiction, it will also create chaos in state tax administration as taxpayers and taxing au-

[1] Letters from the parties consenting to the filing of this brief have been filed with the Clerk of this Court. *See* Sup. Ct. R. 37.2.

thorities struggle to adjust to the extraordinary repercussions of the South Carolina court's decision.

ARGUMENT

I. THE SOUTH CAROLINA SUPREME COURT'S DECISION IS AT ODDS WITH THIS COURT'S UNBROKEN LINE OF DECISIONS PRECLUDING A STATE FROM IMPOSING A TAX UPON A CORPORATION WITH NO PHYSICAL PRESENCE IN THE STATE

In a decision with far-reaching implications for the constitutional restraints on state tax power, the South Carolina Supreme Court has ruled that a state has sufficient nexus with a foreign corporation to subject it to the state's income tax even though the corporation has no physical presence in the state. In so holding, the state court has extended the reach of South Carolina's taxing power far beyond the limits heretofore recognized by this Court.

This Court has consistently found that physical presence is an essential prerequisite to taxing nexus under the Commerce Clause. In *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967) for example, the Court acknowledged that it could not uphold the state's power to impose use tax burdens on an out-of-state mail-order seller with no physical presence in the state without "repudiat[ing] totally the *sharp distinction* . . . [its] decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business." *Id.* at 758 (emphasis supplied).[2]

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[2] For this proposition, the Court cited, among other cases, *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941) (power of a state to impose liability on an out-of-state seller to collect a use tax upheld where seller maintained local retail stores); *Felt & Tarrant Co. v. Gallagher*, 306 U.S. 62 (1939) (power of a state to impose liability

The Court concluded that this "basic distinction" between a taxpayer with physical presence in a state and a taxpayer with no physical presence in a state "is a valid one, and we decline to obliterate it." *Id.* at 758.

The Court emphatically reaffirmed the continuing validity of this distinction in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992), holding that the Commerce Clause precludes a state from requiring an out-of-state mail-order seller with no physical presence in the state to collect and pay use tax on goods sold to customers for use within the state. Recognizing that "the Commerce Clause, and its nexus requirement, are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy" (*id* at 1913), the Court reiterated the "bright-line, physical-presence requirement" of *National Bellas Hess* that must be established before a state can assert its taxing jurisdiction and impose sales and use tax.

Although the Court has explicitly articulated the bright-line, physical-presence test only in cases involving sales and use tax, it has not abandoned that requirement in cases involving other types of taxes. On the contrary, the Court has *never* held that the "substantial nexus" requirement of the Commerce Clause can be satisfied in the absence of the taxpayer's physical presence in the state. The Court observed in *Quill* that all of the cases cited by the North Dakota Supreme Court as evidence of this Court's retreat from a physical-presence requirement, actually "involved taxpayers who had a physical presence in the taxing state and therefore do not directly conflict with the rule of *Bellas Hess* . . . ." *Quill*, 112 S.Ct. at 1914. Similarly, although the Court acknowledged that,

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on an out-of-state seller to collect a use tax upheld where sales were arranged by local agents in the taxing state); *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954) (attempt of state to impose liability on an out-of-state seller to collect a use tax prohibited where seller had no retail outlets or sales solicitors in state).

in its review of other types of taxes, it had not explicitly articulated the same physical-presence requirement that *National Bellas Hess* established for sales and use taxes, the Court was clear to point out that "that silence does not imply repudiation of the *Bellas Hess* rule." *Quill* at 1914.

Indeed, in *National Geographic Soc'y v. State Bd. of Equalization*, 430 U.S. 551 (1977), this Court suggested that a state may have to establish even more significant contacts with a taxpayer in order to sustain the imposition of a direct tax, such as an income tax, than to sustain the imposition of mere use-tax-collection responsibilities. *Id.* at 558. The Court pointed out that, unlike the burden imposed by an income tax, the sole burden on an out-of-state seller forced to collect use tax is an administrative one. *Id.* Moreover, when only use-tax-collection responsibilities, as opposed to income tax liability, is at issue there is "no risk of double taxation . . . [t]he consumer's identification as a resident of the taxing state is self-evident" and "[t]he out-of-state seller becomes liable for the tax only by failing or refusing to collect the tax from that resident consumer." *Id.* In light of this Court's reasoning, taxpayers everywhere can hardly be blamed for reaching the conclusion that, at the very least, a taxpayer must have some physical presence in a state before that state can impose an income tax.

The clear principle of taxation established by this Court, both explicitly and implicitly, is that physical presence is an indispensable precondition to the exercise of state tax power under the Commerce Clause. The South Carolina Supreme Court has issued a decision that ignores that clear principle, thereby unilaterally redefining the boundaries of state taxing jurisdiction. The lower court's disregard of this Court's criteria for determining when a state has taxing jurisdiction plainly warrants this Court's plenary review. At the very least, it is the prerogative of this Court—not a state court—to determine whether its established principles of state tax jurisdiction should be

overturned. *Rodriguez de Quijas v. Shearson American Express, Inc.*, 490 U.S. 477, 484 (1989).

II. THE SOUTH CAROLINA SUPREME COURT'S DECISION RAISES CONCERNS OF GREAT PRACTICAL SIGNIFICANCE THAT SHOULD BE CONSIDERED BY THIS COURT

Wholly apart from the conflict that the South Carolina decision creates with prior decisions of this Court, the decision's practical implications are so inimical to the free trade purposes underlying the Commerce Clause that it should not be left to stand. In essence, the decision has redefined the boundaries of state taxing jurisdiction. The consequences of this revised vision of state taxing power have enormous consequences for taxpayers, including small retailers and individuals who have businesses that stretch across state lines. In its certiorari petition, Geoffrey apprised the Court of some of the astonishing ramifications of the decision below. *See* Pet. at 9, 20-23.[3] While the implications of the state court's decision are a source of considerable anxiety to members of NRF, amicus will not burden this Court with a rehearsal of that "parade of horribles." Pet. at 20. Rather, amicus wishes to draw the Court's attention to some additional repercussions of South Carolina's decision that create special problems for the retail industry.

First, the state court's decision will create an artificial distinction between sales and use taxes and income taxes that will affect all types of enterprises, but especially retailers. Under this Court's precedents in *National Bellas Hess* and *Quill*, an out-of-state retailer with no physical presence in a state will not be subject to sales and use tax collection responsibilities in that state; however, the decision below, if left undisturbed, will allow a state to impose an income tax on an out-of-state retailer if that retailer's intangible property is used by others in the

[3] Citations to the petition for a writ of certiorari in this case are designated "Pet." followed by a page reference.

state. A situation thus will be created whereby the very same transaction may subject an out-of-state retailer to direct income taxation but not to sales and use taxation collection responsibilities.

The anomalous effects of such a situation are best demonstrated by applying the rule of the decision below to the fact pattern in *National Bellas Hess*, a case regularly cited as an example of the constitutional protection guaranteed to retailers engaged in interstate commerce. The taxpayer in *National Bellas Hess* was an out-of-state mail-order retailer with no physical presence in Illinois. Despite the lack of physical presence, the taxpayer directed an extensive credit operation in the state. *See National Bellas Hess* at 761 (Fortas, J., dissenting). Indeed, it appears that a substantial part of National Bellas Hess' sales were on credit with many purchases requiring no money down but rather monthly payments which included a service fee or interest charge. *Id.* In South Carolina's "brave new world of state taxing jurisdiction" (Pet. at 22), the use of any intangibles in a state, including accounts receivable such as those created by the credit transactions in *National Bellas Hess*, will subject the owner of those intangibles to income tax in that state. Ironically, therefore, the very same retail transaction that the Commerce Clause shields from the reach of Illinois' sales and use tax jurisdiction under *National Bellas Hess* (and now *Quill*) would not be so protected from Illinois' income tax jurisdiction under the decision below. The Commerce Clause analysis that would justify such a bifurcated treatment of a single transaction is difficult to fathom. In any event, this Court should not relegate to the cursory opinion of the court below the promulgation of a Commerce Clause doctrine that countenances one nexus standard for sales and use taxes and a different and even lower standard for income taxes which impose as great of a burden on interstate commerce and where a bright-line test would be equally beneficial.

As well as being theoretically unsupportable, an artificial distinction between sales and use taxes and income taxes will throw state tax administration into disarray with particularly unfavorable consequences for retailers. The settled rules by which retailers have structured their operations and to which they have conformed their reporting obligations will suddenly be characterized by confusion and uncertainty. State taxing authorities can be expected to press their new found taxing power to its logical limits, *see* Pet. at 20-22, with the result that taxpayers will be overwhelmed with income tax audits and assessments from every conceivable state and local jurisdiction in which the taxpayer has ever possessed accounts receivable or other intangible assets. This expansion of state taxing jurisdiction is of particular concern to the retail industry which often extends credit to its customers in addition to making retail sales.

Nor is this the only concern of retailers. The South Carolina decision could have a dramatic impact upon the relationship of the retail industry to its sister industry of manufacturing. Manufacturers often sell goods to retailers on credit thereby creating accounts receivable in various states where the manufacturer has no physical presence. Under South Carolina's expanded notion of taxing jurisdiction, such transactions would subject the manufacturers to income tax in the states in which the retailers operated. Similarly, retailers "use" a vast and diverse array of intangible property to sell merchandise. For example, a typical retailer sells goods bearing trademarks: (1) owned by the manufacturer (KLEENEX® tissue by Kimberly Clark); (2) licensed to the retailer by parties which do not sell the subject goods to the retailer (LIZ CLAIBORNE® clothing made by dozens of manufacturers); (3) licensed by manufacturers and used on goods sold to the retailer (MICKEY MOUSE® underwear sold by Wundies); and (4) owned by the retailer or its subsidiaries. The same four ownership regimes apply to ex-

ploitation of other forms of intangible property—patents, copyrights, trade names, and even trade secrets. Take each one of these intangible properties, multiply it by the tens of thousands of items sold in retail stores across the country and try to determine the tax liability of each retailer, each licensor, and each licensor of a manufacturer in any given state. This would be the logical result of the South Carolina Supreme Court's decision. Royalties for exploitation of such properties, if they are not paid outright as a separate fee, are built into prices at each step in the chain of distribution. The complexity of the task of identifying and paying the proper taxes is so great that non-compliance is virtually guaranteed.

The adverse impact of this exposure of manufacturers to tax in jurisdictions in which they have no ~~physical~~ presence will be significant. These adverse consequences include, but are not limited to the following: manufacturers will be less willing to extend credit to retailers; the cost of the use of tradenames will rise; the price of retail products will increase; litigation costs will increase dramatically; and significant tax consequences will result from retroactive application of taxing authority by states in which taxpayers have heretofore not filed income tax returns (due to no physical presence) and therefore the applicable statute of limitations has not expired.

The effect of the decision below will be considerable, and that effect will be disproportionately felt by NRF's small and individually-owned members. Indeed, the decision below may have a chilling effect on those least able to respond to the states' new demands. For example, the burdens on a housewife in the business of making brownie recipes available to chain stores may be prohibitive. New enterprises may be discouraged from starting up and small businesses may be forced to cut back on any activity that reaches across a state line.

In addition, the compliance burdens that will result from South Carolina's expanded definition of state tax

jurisdiction will be considerable. In *National Bellas Hess*, this Court recognized that saddling an out-of-state seller with use tax collection obligations would entail substantial burdens. The Court observed that "[t]he many variations in rates of tax, in allowable exemptions, and in administrative and record-keeping requirements could entangle National's interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose a 'fair share of the cost of the local government.'" *National Bellas Hess* at 759-60. A similar, if not more onerous, burden would be imposed on taxpayers required to pay state and local income taxes in jurisdictions in which the taxpayer has no physical presence. The Court concluded in *National Bellas Hess* that "[t]he very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements." *Id.* at 760. The same conclusion applies here.

III. CONSIDERATIONS OF *STARE DECISIS* STRONGLY FAVOR REVIEW OF THE DECISION BELOW

Taxpayers have structured their businesses in reliance upon a set of principles established by this Court. *See supra* pp. 3-5. If South Carolina's decision is left undisturbed and these principles are abandoned, the economic hardship to taxpayers, both in terms of additional tax liability and in the cost of complying with a whole new set of jurisdictional rules, will be considerable. *See supra* pp. 5-9. Principles of *stare decisis* thus provide an additional reason for this Court to grant review of the decision below.

This Court has consistently placed great weight on reliance interests when invoking the doctrine of *stare decisis*. Indeed, "[c]onsiderations in favor of *stare decisis* are at their acme . . . where reliance interests are involved." *Payne v. Tennessee*, 111 S. Ct. 2597, 2610 (1991). In

Arkansas Electric Cooperative Corp. v. Arkansas Pub. Serv. Comm'n, 461 U.S. 375 (1983), this Court observed that "the principle of *stare decisis* counsels us here, as elsewhere, not lightly to set aside specific guidance of the sort we found in *Attleboro*." *Id.* at 391. The Court's decision in *Arkansas Electric* to set aside the rule of its earlier decision, was due in part to the fact that the Court could "see no strong reliance interests" that would be upset by the rejection of the rule.

Unlike the situation in *Arkansas Electric*, there are "strong reliance interests" at stake in this case. As the Court observed in *Quill*, the bright-line physical-presence requirement has "engendered substantial reliance and has become the framework of a sizeable industry." *Quill* at 1916. This is no less so in the income tax arena than in the sales and use tax arena. Businesses, including members of the NRF, have relied on this Court's precedents in structuring their commercial activity on the predicate that physical presence is a prerequisite to taxing nexus. Consequently, before allowing the South Carolina Supreme Court to jettison the established juridsictional principles reflected in this Court's earlier decisions (*see supra* pp. 3-5), and, along with them, the reasonable reliance interests of state taxpayers, it is incumbent upon this Court to consider those interests.

Moreover, there are other reasons for applying the bright-line, physical-presence test to income tax jurisdiction beyond the hardship suffered by taxpayers. Indeed, many of the reasons the Court articulated in *Quill* to justify the application of the bright-line rule to sales and use tax jurisdiction apply with equal force to income tax jurisdiction. Like a bright-line rule in the sales and use tax area, a bright-line rule in the income tax area "firmly establishes the boundaries of legitimate state authority . . . and reduces litigation. . . ." *Quill* at 1915. It "encourages settled expectations and, in doing so, fosters investment by businesses and individuals." *Id.* at 1915.

And it promotes the " 'orderly development of the law' that undergirds the doctrine of *stare decisis*. *Id.* at 1916 quoting *Runyon v. McCrary*, 427 U.S. 160, 190-191 (1976).

South Carolina has issued a decision that, in substance, rewrites the rules governing state taxing jurisdiction. Not only is this revision at odds with this Court's own criteria for state jurisdiction to tax, the decision below will subject taxpayers to sever economic burdens that they had no reason to anticipate. Principles of *stare decisis* therefore strongly counsel that this Court review the decision below.

CONCLUSION

The petition for a writ of certiorari should be granted.

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Dated: November 1, 1993

No. 93-520

Supreme Court, U.S.
FILED
NOV 4 1993
OFFICE OF THE CLERK

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Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH CAROLINA

BRIEF FOR THE OHIO CHAMBER OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONER

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November 4, 1993

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No. 93-520

IN THE

Supreme Court of the United States

October Term, 1993

GEOFFREY, INC.,
Petitioner,

vs.

SOUTH CAROLINA DEPARTMENT OF
REVENUE AND TAXATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE
SUPREME COURT OF SOUTH CAROLINA

BRIEF FOR THE OHIO CHAMBER OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF THE PETITIONER

This brief in support of the Petitioner is submitted with the written consent of counsel to the parties, copies of which accompany this brief and are being filed with the Clerk of the Court.

INTEREST OF *AMICUS CURIAE*

The Ohio Chamber of Commerce ("OCC") is a statewide organization with over 5,000 members that represents the interests of a diverse cross-section of business, industry, and private enterprise in Ohio. The OCC has a vital interest in the equitable and efficient administration of state tax laws and policies that affect the business community. Of particular importance to the membership of the OCC is the increasingly complex and costly multi-state tax compliance burden being placed on the business community as each individual State attempts to reach beyond its own borders in search of increased tax revenue.

The decision of the Supreme Court of South Carolina in this case will have a profound effect on a substantial number of Ohio businesses that have licensed others to use their intangible property outside Ohio. Heretofore, if an Ohio business had no physical presence in a State, it was widely believed in the business community, based on decisions of this Court, that such State lacked authority under the Constitution to exercise its taxing jurisdiction over the Ohio business. Because the decision of the Supreme Court of South Carolina is a significant departure from established legal principles, the OCC has a strong interest in the issues presented in the Petition for a Writ of Certiorari.

SUMMARY OF ARGUMENT

The Supreme Court of South Carolina affirmed the trial court's holding that the Petitioner, as licensor of various trademarks used by a related corporation in South Carolina, was subject to the State's income tax and business license fees, despite the fact that the Petitioner has no employees or offices in South Carolina and owns or leases no tangible property situsued there. In so holding, the South Carolina court rejected Petitioner's contention that it lacked a nexus with South Carolina sufficient to satisfy either the Commerce Clause or the Due Process requirements of the Constitution. Both of Petitioner's arguments regarding the errors of the decision below merit review by the Court.

The South Carolina court erroneously concluded that physical presence is not a prerequisite to establishing substantial nexus for Commerce Clause purposes. That holding is inconsistent with the contrary consensus that has long prevailed between taxpayers and the States. In departing from that consensus, the South Carolina court's decision exposes owners of intellectual and other intangible property both to open-ended income tax liability for past years and to the heavy burden of complying with the reporting requirements of more than 6,000 taxing jurisdictions. This will seriously restrict the interstate commerce in such intangible property. If the bright-line physical presence test is not to be applied with respect to income taxation, that decision should be made only through the legislative process where appropriate accommodations can be made to deal with prior-year obligations and to prevent a disruption of this increasingly important element of interstate commerce. In addition, the South Carolina court's expansive standard for determining the existence of the minimum contacts required for Due Process nexus is so terribly overbroad that it extends the concept of minimum contacts beyond recognition and leads to irrational results.

ARGUMENT

1. Substantial Nexus for Commerce Clause Purposes Requires a Physical Presence That Does Not Exist in This Case.

This Court has never sanctioned the imposition of a state income tax on an entity organized under the laws of another State that has no physical presence in the taxing State through the presence of employees or agents or the ownership or lease of tangible personal property. It is thus a gross mischaracterization of the law for the Supreme Court of South Carolina to say that, for Commerce Clause purposes: "It is well settled that the taxpayer need not have a tangible, physical presence in a state for income to be taxable there." Pet. App. A at 9a.[1]

The South Carolina court understandably cites no decision of this Court as authority for its conclusion. Neither does it cite decisions of any other courts. Apparently, the only basis for its conclusion is language in the Court's opinion last term in *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992). That case involved a State's ability under the Constitution to require an out-of-state mail order vendor with no physical presence in the taxing State to collect the State's use tax on sales to its residents. In its prior decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), involving that identical question, the Court held that a State cannot impose such an obligation on a seller "whose only connection with customers in the [taxing] State is by common carrier or the United States mail." 386 U.S. at 758. The Court in *Quill* rejected North

[1] All citations herein to Appendices to the Petition for a Writ of Certiorari are referred to by "Pet. App." followed by the letter designation of the Appendix and a page reference.

Dakota's argument that the bright-line physical presence test enunciated in *Bellas Hess* was no longer part of the Commerce Clause "substantial nexus" requirement. In that context, however, the Court stated,

> "Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule."

112 S. Ct. at 1914.

The South Carolina court mischaracterized the foregoing statement as a rejection of the physical presence requirement in the context of taxes other than use taxes. In footnote 4 the South Carolina court stated:

> "The U.S. Supreme Court recently revisited the physical presence requirement of *Bellas Hess* and, while reaffirming its vitality as to sales and use taxes, noted that the physical presence requirement had not been extended to other types of taxes."

Pet. App. A at 9a.

The Court has not articulated the physical presence requirement in the context of other types of taxes simply because the issue has not been presented since 1977 when the Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), formulated the currently applicable tests for sustaining a tax against Commerce Clause challenge. To conclude from that vacuum that the physical presence requirement "ha[s] not been extended to other types of taxes" is simply wrong; worse, to conclude that the physical presence requirement has no application beyond use taxes is to compound the error.

If anything is "well settled," it is that a taxpayer must have a tangible, physical presence in a State for its income to be taxable there. In *Quill* the Court pointed

out that all of the cases cited by the North Dakota court to support its conclusion that recent cases of the Court had "signalled a 'retreat from the formalistic constrictions of a stringent physical presence test . . . .'" (quoting from *State v. Quill Corp.*, 470 N.W.2d 203, 214 (N.D. 1991)), "involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of *Bellas Hess* . . . ." *Quill*, 112 S. Ct. at 1914. It is thus not surprising that the South Carolina court could not cite a single case supporting its contrary proposition. Based squarely on *Bellas Hess* and reaffirmed last term by *Quill*, physical presence has commonly been thought by both taxpayers and taxing authorities to be the touchstone of jurisdiction to tax under the Commerce Clause. As such, physical presence is a line that, in the context of income taxes, is only slightly less bright than it is in the context of use taxes. The absence of any decisions of the Court on the point in the income tax context attests to the widespread consensus among taxpayers and the States that physical presence is necessary to satisfy the "substantial nexus" requirement of the *Complete Auto* test. Indeed, if that were not so, Quill would be subject to income tax in North Dakota even though not required to perform the administrative duty of collecting that State's use tax. Such a result would make no sense at all.

South Carolina itself evidently thought that physical presence was required at the outset of this case. The South Carolina Tax Commission (the "Commission") initially proposed income tax deficiencies against Toys "R" Us, the entity licensed to use Petitioner's trademarks, based on the disallowance of the deductions claimed for trademark royalties paid to Petitioner. Only after Toys "R" Us protested that assessment did the

Commission assert, and then only as an alternative argument, that the Petitioner itself was subject to South Carolina income tax on those royalties.

The error by the South Carolina court stems from its failure to recognize that the trial court based its decision on a clearly erroneous view of the substantial nexus requirement. The trial court decision rests squarely on the premise that the nexus requirement is the same for both Due Process and Commerce Clause purposes. The trial court characterized that requirement as some "minimal connection"—"whether the state has provided some protection, opportunity, or benefit for which it can ask a return [citing *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940).]." We now know from *Quill* that the Due Process and Commerce Clause nexus requirements are not the same and that the minimal connection language characterizes the Due Process test, not the Commerce Clause test. *Quill* teaches that,

> "while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause."

112 S. Ct. at 1909.

The Supreme Court of South Carolina (unlike the trial court) had the benefit of *Quill*, but it seemed completely oblivious to the distinction drawn there between Due Process nexus and Commerce Clause nexus. While *Quill* makes clear, in the context of the use tax collection duty, that "the requirements of due process are met irrespective of a corporation's lack of physical presence in the taxing State," 112 S. Ct. at 1911, *Quill* emphatically rejected extending that holding to the Commerce Clause "substantial nexus" requirement. Yet that is precisely what the Supreme

Court of South Carolina has summarily done here. If allowed to stand, the decision in this case will quickly become the opening shot in the States' efforts to extend their taxing jurisdiction to entities whose contact with and presence in the State is no more substantial than in the present case. In crossing what has heretofore been a line no less clear, though less explicitly articulated, than the one drawn in *Bellas Hess* (and only recently reaffirmed in *Quill*), the consequence will be to subject a significant segment of interstate commerce to far greater compliance and liability burdens than ever thought possible up to now. As the Court pointed out in *Quill*, there are more than 6000 taxing jurisdictions in this country. Given the revenue pressures to which those jurisdictions typically are subject, it is unrealistic not to expect that all of them will quickly seek to exploit the taxing monster created by the South Carolina court's decision.

It is not only the ongoing burden on interstate commerce that is implicated in this case. Precisely because physical presence has been regarded by both taxpayers and taxing jurisdictions as a requirement of the Commerce Clause, few taxpayers without physical presence in a State have ever filed income tax returns in that State. That leaves them open to substantial unanticipated liabilities for back income taxes, interest, and penalties. Moreover, there is no limit to that liability since rarely, if ever, does a State's statute of limitations begin to run absent the filing of a return.

While the Court has made it clear that interstate commerce "may be made to pay its own way," *Complete Auto*, 430 U.S. at 289 n.15, limits remain. The Commerce Clause exists as a "means for limiting state burdens on interstate commerce." *Quill*, 112 S. Ct. at 1913. Until

now, physical presence has served as the bright line that divides the burdensome, prohibited income tax from the permitted income tax. The settled expectations of taxpayers in that regard are best left for Congress and the political process to undo, particularly given the retroactive liabilities implicated by the sweeping principle enunciated by the South Carolina court. If entities like Petitioner are to be required to pay income taxes to States in which their contacts and presence are as thin as they are here, it is Congress that should make that decision, with such safe harbors and limitations as may be determined after appropriate opportunity for hearings to consider the economic implications of such a course. For example, see Public Law 86-272, 73 Stat. 555 (1959), 15 U.S.C. §381 *et seq.*, recently construed by the Court in *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 112 S. Ct. 2447 (1992).

2. The Physical Presence Requirement is Not Satisfied by Petitioner's Intangible Property.

While the South Carolina court summarily rejected in one sentence Petitioner's reliance on the physical presence test, the court also held that Petitioner satisfied that test, based on "licensing intangibles for use in this State and deriving income from their use here." Pet. App. A at 10a. The only direct authority for that proposition cited by the South Carolina court was *American Dairy Queen Corp. v. Taxation and Revenue Dept.*, 93 N.M. 743, 605 P.2d 251 (1979). That decision by an intermediate appellate court did not analyze the Commerce Clause nexus issue, but merely concluded that the issue had already been decided adversely to the taxpayer in two prior decisions of the same New Mexico Court of Appeals involving similar but different taxpayers: *Baskin-Robbins Ice Cream Co. v. Revenue*

Div., 93 N.M. 301, 599 P.2d 1098 (1979), and *Aamco Transmissions v. Tax. & Rev. Dept.*, 93 N.M. 389, 600 P.2d 841 (1979). However, neither of those cases involved the Commerce Clause issue present here. In *Baskins-Robbins*, the Court of Appeals concluded that the license agreement involved was "completely performed in New Mexico by [the licensee], so that the performance of the contract is not within the protection of the Commerce Clause." 599 P.2d at 1101. Only intrastate commerce was involved. "The Commerce Clause plays no part in the instant case." 599 P.2d at 1102. Far from interpreting the Commerce Clause substantial nexus requirement, *Baskins-Robbins* disavowed any Commerce Clause aspects to the case.

Aamco Transmissions reached the same conclusion. In addition, the licensor was found to be leasing tangible property (its signs) in New Mexico. A case subjecting a taxpayer that has a physical presence in New Mexico to tax provides no support for subjecting an entity that has no physical presence to tax.

At bottom, the New Mexico cases cited by the South Carolina court simply are not authority for the proposition that intangible property alone can establish substantial nexus for Commerce Clause purposes. In any event, any implication drawn from those cases that licensing intangible property in the State provides the required "substantial nexus" is completely undercut by the Court's decision in *Quill*. Noting that Quill also licensed software to some of its North Dakota clients, the Court agreed that "the existence of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus" [quoting from the State's brief].

> "We therefore conclude that Quill's licensing of software in this case does not meet the 'substantial nexus' requirement of the Commerce Clause."

112 S. Ct. at 1914 n.8.

If Quill's purposeful licensing of software directly to customers residing in North Dakota does not meet the substantial nexus requirement, Petitioner's licensing of trademarks to Toys "R" Us that Toys "R" Us later determines (without the involvement of Petitioner) to use in South Carolina even more clearly fails that requirement.

The South Carolina court also referred to this Court's decision in *International Harvester Co. v. Wisconsin Department of Taxation*, 322 U.S. 435 (1944), as indirect support for its conclusion that the presence of intangible property alone (rather than physical property) is sufficient to establish nexus. However, only the Due Process Clause was at issue in *International Harvester*; the Commerce Clause was not involved. Since that case dealt with "whether the taxing power exerted by the state bears fiscal relation to protection, opportunities, and benefits given by the state," (quoting *Wisconsin v. J.C. Penney Co., supra*, at 441-442 (1940)) for purposes of the Due Process Clause, the decision no longer has any relevance to whether Petitioner has substantial nexus with South Carolina for Commerce Clause purposes.

The South Carolina decision is nothing less than the adoption for Commerce Clause substantial nexus purposes of the exploitation of the market theory urged by North Dakota in its case against Quill. This Court in *Quill* rejected that theory. Adoption of such a broad sweeping nexus standard and departure from the physical presence requirement, if it is to be done, should be left to Congress and the political process. As the

Court pointed out in *Quill*, the substantial nexus requirement (as well as, to a lesser extent, the "fairly related to the services provided by the taxing state" prong of the *Complete Auto* test) is "a means for limiting state [tax] burdens on interstate commerce." It would be hard to imagine any more burdensome requirements on interstate commerce than will attend the activities of entities like Petitioner if the South Carolina decision is allowed to stand.

One need look no further than the example of the recently retired superstar of the Chicago Bulls, Michael Jordan. The newspapers have well documented the huge cash cow that the business of licensing the man's name and likeness have become. It is fair to say that, under the South Carolina court's decision, all of the nation's 6000 plus taxing jurisdictions can claim the right to tax a piece of that cow, based on nothing more than the purchase of goods bearing the Jordan likeness and name by customers in the jurisdiction. The compliance cost burden in that event is self evident. It would be a startling development indeed if the Commerce Clause no longer stands as a barrier to the imposition of such burdens on commercial enterprise.

Only as part of a legislative process can an appropriate balance be struck between the revenue interests of the 6,000 various taxing jurisdictions throughout the country and the difficulty that many of the participants in the interstate commerce in intangible property will encounter in shouldering the enormous burden of complying with the multiple requirements of those jurisdictions. The Court in *Quill* noted that many of these burdens might now be bearable in light of the technological advances in computers that have occurred since its earlier decision in *Bellas Hess*. However, while that may be generally true with respect to some large

enterprises that purposefully and systematically market tangible property in the various States, the same cannot be said as broadly and with the same level of confidence about those who sell intangible property in interstate commerce. Consider, for example, the inventor who licenses a patent or other technology to a licensee that, without any further involvement from the licensor, applies the technology throughout the country. Likewise, consider the artist who licenses his or her copyright but does not control where the artistic work will be performed. The same example could be framed in the context of other owners of intellectual or other intangible property who commercially license their property but, as is often the case in such transactions, do not control how or where it is used.

For such persons engaged in the interstate commerce in ideas and similar intellectual property, the broad test of nexus advanced by the South Carolina court could be severely debilitating by requiring them to account for their income to an untold number of independent taxing jurisdictions with widely differing reporting requirements. Unlike the large mail-order enterprises considered in *Quill*, many of these entrepreneurs will find it burdensome, and often economically impractical, to access the necessary computer technology to comply with the laws of the myriad taxing jurisdictions to which the South Carolina nexus rule will expose them.

The bright-line physical presence test has served to prevent such consequences. If that test is to be abandoned, it should be replaced with a test that can accommodate the competing considerations in a way that will minimize the negative impact on this important commerce in intangible property. That, however, is most effectively accomplished through legislation because the

judicial process is simply not as well-suited as is the legislative process to effect such delicate accommodations. In particular, it would be more appropriate that a legislative judgment, rather than a judicial pronouncement, be the basis for a determination, such as that urged by South Carolina, that one test for nexus applies with respect to one type of tax and an entirely different test applies with respect to another type of tax. In the absence of such legislation, OCC urges the Court not to abandon the bright-line physical presence test of Commerce Clause nexus.

Because of this substantial impact on the increasingly important interstate market in intellectual property and similar intangibles, the Commerce Clause issue in this case plainly warrants the Court's review.

3. The South Carolina Court Has Misinterpreted the Due Process Minimum Connection Requirement.

The state court seriously erred in concluding that Petitioner's contacts with South Carolina satisfy the "minimum connection" requirement of the Due Process Clause. The court's conclusion was based on the twin premises that Petitioner purposely directed its activities toward South Carolina and that Petitioner had intangible property in the State. Neither premise can stand. Petitioner itself did nothing purposefully directed toward South Carolina. It merely licensed its trademarks to Toys "R" Us at a time, it should be noted, when South Carolina was not even in the picture. The South Carolina court either confused the activities of Toys "R" Us in South Carolina, which clearly satisfy the minimum connection requirements as to Toys "R" Us, with the activities of Petitioner, none of which were purposely directed toward South Carolina, or it was attributing the activities of Toys "R" Us to Petitioner. There is simply

no basis for either conclusion. Toys "R" Us was not the agent of Petitioner in soliciting sales, or licenses of trademarks in South Carolina. Its activities in the State were solely for its own benefit. While those activities of Toys "R" Us necessarily employed Petitioner's trademarks that it was licensed to use, there was nothing intentional or purposeful in that respect that could be attributed to Petitioner.

Indeed, the South Carolina court did not determine otherwise. Rather, the sole basis for saying that Petitioner "purposefully directed its activities toward South Carolina" is that it did not prohibit Toys "R" Us from using the licensed trademark in that State. The OCC respectfully submits that placing such a spin on the "purposefully directed" characterization is a quantum leap from the direct and purposeful activities of the taxpayer that were held to satisfy the minimum connection requirement in *Quill*. The South Carolina court's test fundamentally destroys the substance of the minimum connection standard. Any entity that licenses another to use a trademark or other intangible property will be subject to tax in every jurisdiction in which the licensee uses such intangible property. The activities of the licensee, not the licensor, will become the touchstone of tax liability. The OCC submits that such an unexpected expansion of the Due Process nexus requirements offends "traditional notions of fair play and substantial justice." *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945).

The South Carolina court's second premise, that the "minimum connection" required by due process was satisfied by the presence in the State of Petitioner's intangible property, is equally flawed. The court concluded that sales in South Carolina by Toys "R" Us created accounts receivable in favor of Petitioner,

presumably because the trademark royalties payable are based on a percentage of sales by Toys "R" Us. But the court leaps from that fact to the conclusion that the accounts receivable are South Carolina property. Even if it is conceded that South Carolina sales of Toys "R" Us create accounts receivable, it does not follow that South Carolina is the situs of those receivables. Toys "R" Us, not its South Carolina customers, is the debtor. The court cites no authority for its extraordinary conclusion that Petitioner's accounts receivable from Toys "R" Us have a South Carolina situs, but merely assumes that to be the case. That result makes a mockery of the "minimum connection" standard. That test would be satisfied in every jurisdiction in which Toys "R" Us made a sale that gives rise to an obligation to pay a royalty to Petitioner. Indeed, it will lead to the absurd conclusion that two otherwise identically situated taxpayers will be treated differently for purposes of the Due Process nexus requirement based solely on whether the sale is a cash transaction or a credit transaction. That is a breathtaking expansion of the "minimum connection" concept. The result will be dramatically different obligations imposed on licensors such as Petitioner than were heretofore thought possible. Such a giant step warrants this Court's careful review.

4. The Relationship Between Petitioner and Toys "R" Us Does Not Justify Lowering Commerce Clause or Due Process Nexus Standards.

Although the South Carolina court does not explicitly discuss the point, one cannot read the decision without sensing a strain on the part of the court to prevent what it may have perceived was the tax avoidance otherwise achieved by the arrangement between Petitioner and Toys "R" Us. It is conceded that

the use of a Delaware holding company to license trademarks reduces the state tax burden of the Toys "R" Us group of which Petitioner is a part—or at least it did until this case. That consequence is a well understood attribute of the use of Delaware holding companies. On the one hand, there is no justification for treating the Petitioner as other than a separate corporate entity from Toys "R" Us, particularly in the absence of any evidence that the Petitioner is a sham or lacks economic substance—a determination that the South Carolina courts have not made. In the federal income tax context, this Court has long held that such substantial corporations must be recognized as entities separate and distinct from their shareholders. *See, e.g., Moline Properties, Inc. v. Commissioner,* 319 U.S. 436 (1943), and *National Carbide Corp. v. Commissioner,* 336 U.S. 422 (1949). In that light, it is appropriate to apply to the Petitioner the same principles that would be extended to an unrelated owner and licensor of the trademarks. That, of course, is what makes the decision of the South Carolina court so extraordinary.

On the other hand, the OCC is not an apologist for Delaware holding companies or the tax savings they purport to achieve. There are ways of dealing with any perceived injustices that the use of such companies by related entities may produce, such as using the unitary method, requiring combined reporting, or disallowing deductions for amounts such as royalties paid to Delaware holding companies. Indeed, South Carolina initially utilized the latter approach in this case, but for its own reasons elected not to pursue that approach. The point is that the existing constitutional nexus standards should not, and need not, be eviscerated merely to remedy perceived abuses arising from the use of Delaware holding companies by related parties, especially when the

States have readily acknowledged tools for addressing any such concerns. That, *sub silentio*, is what the South Carolina court has done here. While this case involves use of a Delaware holding company by related entities, the constitutional principles at issue are not limited to that situation, but apply as well to unrelated entities that are not part of a holding company structure. The implications of this case in the context of related taxpayers are nothing short of extraordinary. The implications in the context of unrelated taxpayers are staggering.

CONCLUSION

This case is another battle in the unceasing war between the States and taxpayers over who is subject to tax. The South Carolina court has declared victory for the State by brushing aside existing notions of the standards governing nexus for Commerce Clause and Due Process purposes. The court seems not to have appreciated the factual distinctions that make this case unusual and the result so astonishing. If the judgment is not reversed, and the governing principles clarified, entities, like Petitioner, operating in interstate commerce will assuredly find themselves subject to greatly expanded ongoing liability and reporting requirements in thousands of jurisdictions—to say nothing of the liabilities for taxes their past activities might have engendered. The issues posed in this case are of far-reaching concern to a substantial portion of the business community. The South Carolina court resolved these issues in a fashion that the OCC believes is not only fundamentally wrong, but will also do serious harm to interstate commerce if not reversed.

Accordingly, OCC respectfully urges that the petition for a writ of certiorari to the Supreme Court of South Carolina be granted.

Respectfully submitted,

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November 4, 1993

Supreme Court, U.S.
FILED
NOV - 9 1993
OFFICE OF THE CLERK

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PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

The theoretical and practical significance of the question presented by Geoffrey in its petition—whether a licensor of intangible property is subject to tax wherever its licensee uses the property—cannot seriously be denied. It is therefore understandable that respondent's brief in opposition amounts largely to an effort to divert the Court's attention from this question. Thus respondent claims that the facts of this case do not squarely raise the question presented by the petition because Geoffrey is purportedly more than a passive licensor of intangible property used by a licensee in South Carolina. In this connection, respondent seizes on the state court's characteriza-

tion of Geoffrey as having a "franchise" (Pet. App. A at 5a) in South Carolina as the basis for its contention that Geoffrey operated in the state as an "active franchisor." Opp. at 8. In addition, respondent dismisses the relevance of the implications of the South Carolina court's decision for taxpayers other than Geoffrey because respondent apparently believes that these implications have no bearing on the certworthiness of this case.

Insofar as respondent seeks to address the legal issues raised by Geoffrey, respondent mischaracterizes the precedents on which it relies. Although the Court in *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992), never elaborated on the meaning of the Commerce Clause's "substantial nexus" requirement outside the context of sales and use taxation, respondent would nevertheless read that decision as resolving the "substantial nexus" question in this case. Without even acknowledging the deep division in this Court over the question whether knowledge that one's product may find its way into a state is, without more, a sufficient basis for asserting jurisdiction over a nonresident defendant under the Due Process Clause, *see Asahi Metal Indus. Co. v. Superior Court*, 480 U.S. 102 (1987) (discussed in Pet. at 15-18), respondent contends that Geoffrey is subject to jurisdiction in South Carolina merely because it was "aware its trademarks could be used in South Carolina." Opp. at 17.

As we demonstrate below, none of these assertions, nor others that respondent advances in opposition to the petition, can withstand scrutiny.

I. THE RECORD IS UNDISPUTED THAT GEOFFREY WAS NOT AN "ACTIVE FRANCHISOR" AND THAT GEOFFREY'S ONLY CONNECTIONS WITH SOUTH CAROLINA WERE THOSE OF A PASSIVE LICENSOR OF INTANGIBLE PROPERTY WHOSE LICENSEE CONDUCTED BUSINESS IN THE STATE

A. The Rights That Geoffrey Might Have Exercised—But in Fact Did Not Exercise—In South Carolina Under Its License Agreement With Toys "R" Us Are Irrelevant to South Carolina's Power to Subject Geoffrey to Tax

Throughout its brief in opposition, respondent adverts to rights that Geoffrey possessed under its license agreement with Toys "R" Us in an effort to paint Geoffrey as an "active franchisor" (Opp. at 8) rather than as a passive owner of trademarks used in South Carolina by a licensee. Respondent observes, for example, that "Toys was allowed to . . . receive Geoffrey's 'merchandising skills, techniques and know-how in the operation of [Toys'] business.'" Opp. at 4 (quoting license agreement); that "the license agreement allows Geoffrey . . . to tell its licensee that it does not want the licensee to sell specified merchandise in South Carolina," *id.* at 4-5 (citing license agreement); and that Geoffrey has the authority "to approve what merchandise and services can be sold with its trademark," *id.* at 18 (citing license agreement), "to approve the advertising and sales promotion materials to be used with its trademark," *id.* (citing license agreement), and to "inspect the books and records of the licensee . . . ." *Id.* (citing license agreement).

What respondent fails to tell the Court, however, is that Geoffrey never exercised any of these rights in South Carolina, as the uncontradicted testimony of Louis Lipschitz, Geoffrey's Secretary, reveals:

> Q Mr. Stevens took you through the license agreement and the rights that Geoffrey has under—the

various rights Geoffrey has under that license agreement.

A That's correct.

Q Does Geoffrey now or has it ever exercised any of those rights in the State of South Carolina?

A No, sir.

R. 59.

Respondent's claim that Geoffrey was an "active franchisor" (Opp. at 8) is therefore based on the false premise that Geoffrey actually exercised the rights it had under the license agreement. The record is undisputed that Geoffrey's connections with South Carolina never exceeded those of a passive licensor of intangible property employed by a licensee in the state. South Carolina's jurisdiction to tax Geoffrey plainly must be predicated on what, if anything, Geoffrey actually did in South Carolina, not on what it might have done under the license agreement.[1]

B. Labeling Geoffrey's Rights Under the License Agreement as a "Franchise" Adds Nothing to South Carolina's Constitutional Power to Tax Geoffrey

In its effort to portray Geoffrey as more than a passive owner of trademarks used by a licensee in South Carolina, respondent relies on the state courts' conclusion that Geoffrey had a "franchise" in South Carolina. Opp. at 7-11. In respondent's view, the existence of such a "franchise" provides an independent predicate for the exercise of South Carolina's taxing power. But this Court has recognized, especially in recent years, that the constitutional restraints on state taxing power do not depend on

[1] *Cf. ASARCO Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 320-29 (1982) (actual control, not potential for control, is the test for determining whether the requisite control exists to render two businesses unitary); *F.W. Woolworth Co. v. Taxation and Revenue Dep't*, 458 U.S. 354, 362-72 (1982) (same).

"magic words or labels." *Railway Express Agency, Inc. v. Virginia*, 358 U.S. 434, 441 (1959). Whether a tax is imposed on "the privilege of doing business" in a state or on the exercise of a "franchise" is irrelevant to the constitutional analysis. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977); *Quill*, 112 S. Ct. at 1911-12. Rather, the pertinent question is whether, as a matter of substance, the taxpayer has the "substantial nexus" or "minimum contacts" with a state demanded by the Commerce and Due Process Clauses.

Moreover, seizing on the dictionary definition of a "franchise" quoted by the court below,[2] respondent leaps to the conclusion that Geoffrey is an "active franchisor" (Opp. at 8) conducting a "franchise business . . . in South Carolina," *id.* at 10, thereby conjuring up the image of a McDonald's or a Wendy's with active oversight of the franchisee by the franchisor. The suggestion is preposterous and totally ignores the factual record. *See supra* pp. 3-4.

II. RESPONDENT'S ATTEMPTS TO BELITTLE THE SIGNIFICANT PRACTICAL IMPLICATIONS OF THIS CASE ARE BELIED BY THE RATIONALE OF THE DECISION BELOW, BY THE CONCERNS EXPRESSED BY *AMICI* SUPPORTING PETITIONER, AND BY RESPONDENT'S OWN ADMINISTRATIVE PRACTICE

In an effort to downplay the significance of the decision below, respondent asserts that petitioner "provides no

[2] "In its simplest terms, a franchise is a license from the owner of a trademark or trade name permitting another to sell a product or service under that name or mark. More broadly stated, a 'franchise' has evolved into an elaborate agreement under which the franchisee undertakes to conduct a business or sell a product or service in accordance with methods and procedures prescribed by the franchisor, and the franchisor undertakes to assist the franchisee through advertising, promotion, and other advisory services." Pet. App. A at 5a-6a n.2 (quoting *Black's Law Dictionary* 592 (5th ed. 1979)).

analysis" (Opp. at 8) to justify the conclusion that " '[u]nder the court's ruling, whenever a person's intangible property is used by others, the person will be subject to tax wherever such property is used.' " Opp. at 6-7 (quoting Pet. at 20). Petitioner did not need to provide such analysis because, as petitioner pointed out in its petition, such analysis was provided by the court below.

The *court* declared that "the 'minimum connection' required by due process . . . is satisfied by the presence of Geoffrey's intangible property in this State." Pet. App. A at 5a. The *court* declared that "the presence of these intangibles is sufficient to sustain a tax." *Id.* at 5a-6a. The *court* declared that, under the Commerce Clause, "[t]he presence of intangible property *alone* is sufficient to establish nexus." *Id.* at 9a (emphasis supplied). And the *court* declared that "by licensing intangibles for use in this State and deriving income from their use here, Geoffrey has a 'substantial nexus' with South Carolina." *Id.* at 10a. Under this analysis, one can only wonder how respondent can harbor any doubt about petitioner's conclusion that "authors, television producers, software developers, banks merely holding securities, and athletes making endorsements are subject to . . . taxation under the ruling of the *Geoffrey* decision." Opp. at 7.

In any event, whatever question respondent may have about the enormous consequences of this case, it is plain that a broad cross-section of American industry is deeply concerned about the far-reaching implications of the decision below. The National Retail Federation, the Information Technology Association of America, the International Franchise Association, the Tax Executives Institute, the Committee on State Taxation, and the Ohio Chamber of Commerce have all filed *amicus* briefs registering their anxieties over the ramifications of the South Carolina court's decision and urging this Court to grant review of the case. The repercussions of the decision

below that are documented in these *amicus* briefs should dispel any doubt about the decision's national significance.

Finally, respondent's protestations that petitioner has inflated the importance of this case are belied by respondent's own administrative practice. Under respondent's "administrative practice" (Pet. App. B at 17a) any activity—whether tangible or intangible—that generates income in the state subjects the taxpayer to state tax liability. "For example, finance companies are taxed in South Carolina based on whether the borrower resides in this state." *Id.* Similarly, "[r]estaurant franchise companies that have no activity in the state except the presence of their franchise name from which they derive income are subject to tax in South Carolina." *Id.* Moreover, in late September the respondent announced that it was "reviewing this case further and its application to other intangible property." South Carolina Dep't of Revenue and Taxation, *Information Letter #93-20*, Sept. 22, 1993, reported in [S.C.] St. Tax Rptr. (CCH) ¶ 340-017 (1993). The implications of the sweeping conception of state tax jurisdiction embraced by the decision below are thus fueled by far more than "speculation on the outcome of untried hypothetical arrangements." Opp. at 7-8.

III. THE COMMERCE AND DUE PROCESS QUESTIONS PRESENTED BY PETITIONER ARE SUBSTANTIAL, AND RESPONDENT'S CLAIMS TO THE CONTRARY ARE BASED ON MISCHARACTERIZATIONS OF THIS COURT'S PRECEDENTS

A. Not Only Did *Quill* Leave Open the Question Whether a Commerce Clause "Substantial Nexus" Requirement of Physical Presence Applies Outside the Sales and Use Tax Context, This Is the Ideal Case for Deciding That Question

Respondent's contention that "*Quill* leaves no unanswered question of physical presence as a standard in an income tax" (Opp. at 15) context misreads this Court's

opinion in *Quill* and ignores its antecedents. The Court in *Quill* recognized that in its "review of other types of taxes" it had not "articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes," but rather had been "silen[t]" on the issue. *Quill*, 112 S. Ct. at 1914. There is therefore no basis for respondent's assertion that "[i]n the income tax area . . . there are . . . settled expectations . . . . that no physical presence is required" (Opp. at 15) for a state to establish taxing jurisdiction. In fact, as it observed in *Quill*, the Court has cited *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), with approval in cases involving other types of taxes. *Quill*, 112 S. Ct. at 1912 (citing *Goldberg v. Sweet*, 488 U.S. 252, 263 (1989) (telecommunications excise tax); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 626 (1981) (severance tax); *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 437 (1980) (corporate income tax)). The Court has not articulated a physical-presence rule in the income tax context because it has not had occasion to do so.[3]

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[3] As noted in Geoffrey's petition, the Court has *never* upheld a state tax over Commerce Clause objections in the absence of physical presence by the taxpayer. Pet. at 11-12. Respondent nevertheless cites *Shaffer v. Carter*, 252 U.S. 37 (1920), *Curry v. McCanless*, 307 U.S. 357 (1939), *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936), and *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987) (Opp. at 9-10) for the proposition that "the conducting of an ongoing business in a state by means of an integral intangible establishes a substantial nexus with the state." Opp. at 9. But each of these cases involved taxpayers who had substantial physical presence in the taxing state. *Shaffer* (oil and gas leases); *Curry* (the estate of a domiciliary decedent and local trust companies); *Wheeling Steel* (corporate headquarters); *Tyler Pipe* (sales representatives). Hence these cases scarcely establish the proposition for which they are cited.

Respondent's invocation of three cases decided in the same year by the intermediate appellate court of a single state hardly strengthens its position. *See American Dairy Queen Corp. v. Taxation and Revenue Dep't*, 605 P.2d 251 (N.M. App. 1979); *AAMCO Trans-*

Accordingly, this case presents an ideal opportunity for the Court to decide whether physical presence is required for a state to impose an income tax and, if not, what comprises "substantial nexus" for state income tax purposes. Contrary to respondent's suggestion, this question *must* be resolved in the context of an out-of-state taxpayer with only an intangible presence in the state. If the out-of-state taxpayer had no presence in the state—tangible or intangible—then taxation would clearly be impermissible. If the out-of-state taxpayer had a physical presence in the state, then the Court would never reach the question whether physical presence is required to impose an income tax.

B. Respondent's Contention That the Decision Below "Followed Established Precedent" Under the Due Process Clause Ignores the Division in the Court in *Asahi* Over the Question Presented by This Case

In its petition, Geoffrey pointed out that the question whether a licensee's use of a trademark in a state confers jurisdiction to tax an out-of-state licensor raises a substantial due process issue in light of the deep divisions in this Court over an analogous issue presented in *Asahi*. Pet. at 14-19. Without even citing *Asahi*, respondent asserts that South Carolina's assertion of jurisdiction over Geoffrey meets due process strictures because "Geoffrey has purposefully directed activity toward South Carolina's economic market by consciously allowing and controlling the use of its trademarks in the State." Opp. at 18. In

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missions, Inc. v. Taxation and Revenue Dep't, 600 P.2d 841 (N.M. App.), *cert. denied*, 598 P.2d 1165 (N.M. 1979); *Baskin-Robbins Ice Cream Co. v. Revenue Div.*, 599 P.2d 1098 (N.M. App. 1979). None of the cases meaningfully considered Commerce Clause requirements for establishing nexus or even cited *Bellas Hess*. Moreover, in the 14 years since those cases were decided, they had never been followed, relied on, or even cited (except once for an unrelated proposition) by any court, either in New Mexico or any other jurisdiction, until the South Carolina Supreme Court cited them in this case.

light of *Asahi*, however, it is highly questionable whether merely allowing trademarks to be exploited in South Carolina satisfies the "purposeful availment" component of this Court's "minimum contacts" doctrine. Pet. at 14-19. By failing even to address this point, respondent leaves petitioner's due process contention unanswered.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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